ECONOMIC REBIRTH

The author has tried to show the dangers and difficulties of the post-war economic situation in straightforward language, free from economic technicality and rhetorical vapour.

Total war impoverishes, not only by the destruction directly caused, but by using up a country's future resources There are pressing immediate shortages, and long arrears of expenditure on the upkeep, renewals, improvements and extensions of property and plant. In the hard work and short commons needed for years to come to make good the shortages and to overtake the arrears, the war effort *outlasts the war*

A continuance of controls seems inevitable, and the author offers the suggestion that a great part of the detailed controls could be superseded by a Government monopoly of wholesale dealing.

Great Britain has sustained a full share of this impoverishment, and has in addition suffered disastrous inroads on those external resources on which her power and high standard of living have been founded.

If we attempt to maintain the standard of living by increasing money wages we will reduce the wealth-value of money, and leave real wages where they were. The wealth-value of the pound has been imperilled by the profusion of war finance. If we are to keep faith with the holders of war loans and to sustain the pre-eminence of sterling in world markets, the preservation of the value of the pound is vital, and to that end heroic measures, such as a forced loan, are warranted.

The standard of living can be supported by the social services, but the cost might cause an overburdened fiscal system to break down, and this would put an end to the profit-making system and precipitate the community into collectivism.

By the same Author

ECONOMIC DESTINY
A CENTURY OF BANK RATE
THE GOLD STANDARD
IN THEORY AND PRACTICE

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ECONOMIC REBIRTH

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PREFACE

My book, *Economic Destiny*, which appeared in 1944, though written during the war, had as its subject, the economic disorders which had vexed the world in the years between the two wars, and the future developments to be inferred from the disorders and from the remedies that might be resorted to to correct them. The book looked forward to a long-period evolution, and touched only incidentally on the nearer economic effects which would follow the war then at its height.

In the present work my theme is the immediate post-war economic situation. Actual measures of relief and reconstruction are matters rather of administration than of economics, and do not come within its scope. Economic science is concerned with the institutions under which economic activities are to be carried on; with the motives, pecuniary and other, by which the efforts of individuals are to be directed to the desired ends; with the degree of interference of Governments by way of controls, planning or public enterprise; and with the co-operation and public spirit of classes.

Human society is being subjected to a severe strain, perhaps as severe as any it has ever had to undergo. At such a moment it would be fatal to abandon the search for a rational solution of the problems besetting us, and to lapse into desperate courses. However black the outlook, it is for human reason by cool deliberation to seek the best course in the circumstances, be the best only the least of several evils.

The dark and bitter pessimism characteristic of the present century is cleft by gleams of ardent hope not less

characteristic. To prevail, the hope must be something more than visionary; it must be linked on to immediate practical measures, and particularly to temporary safeguards and expedients to tide over the immediate dangers.

I have now retired from the Government Service, but as I am still engaged on work for the Treasury, I ought to say that what I write represents only my personal views, and is not to be associated in any way with my past official position or my present official work.

March 1946 R. G. HAWTREY

CONTENTS

1. *The Work to do*

"Behold the Lord maketh the earth empty, and maketh it waste and turneth it upside down, and scattereth abroad the inhabitants thereof. And it shall be as with the people, so with the priest; as with the servant, so with the master; as with the maid, so with her mistress; as with the buyer, so with the seller; as with the lender, so with the borrower; as with the taker of usury, so with the giver of usury to him.

"The earth shall be utterly emptied and utterly spoiled, for the Lord hath spoken this word. The earth mourneth and fadeth away; the lofty people of the earth do languish."[1]

Only the words of an apocalyptic vision of old can do justice to the magnitude of the catastrophe which has overtaken this generation. But an apocalyptic vision is an appeal to emotion. It can arouse feeling and wake the people to action, yet it does not tell what action will be right.

The urge to action, blind and without guidance, can only lead to frustration and despair.

Democracy calls upon every responsible individual to be a statesman, that is to say, to form a judgment of what ought to be done. A statesman is not an expert. He listens to experts, and takes advice, but he has to choose what advice to take. He often chooses wrong, but then experts also are often wrong.

It is for the expert to convey his wisdom to his fellow-

[1] The opening of a majestic utterance interpolated in the Book of Isaiah (chapters xxiv-xxvii). The occasion is believed to have been the break-up of the Persian Empire in the fourth century B.C., culminating in the conquest by Alexander the Great.

men. His may be dubious wisdom, but the expert, conscious of his fallibility, ought to welcome the test. He ought to be glad to subject his views to criticism. The sage, content to remain wrapt up in his own speculations, is no expert. Only when he communicates his wisdom to others, and supplies them with the grounds of action, does he emerge from Cloud Cuckoo Land.

Mankind has reached a phase of civilization in which life has become bewilderingly complicated. Experts multiply, each specializing in his own convolution of the pattern. To enable a community to solve its problems, a compendious unifying statement of the situation as a whole is needed, a statement intelligible to the non-expert mind, such as to impress upon it the salient characteristics, on one side, of the disorders and, on the other, of the remedies.

The pages that follow embody an endeavour towards meeting this need in the economic sphere. That, it may be said, is a limitation; the economist is only one kind of expert. But if, as I should maintain, the subject matter of economics is *work*, guidance as to what work should be done, and how the community should be organized to do it, is comprehensive enough.

2. *Let-do*

Portentous events in the present century have given a new meaning to war. A century ago John Stuart Mill thought that the facility and rapidity with which countries recovered from the ravages of war called for an explanation. The economic loss, he pointed out, took the form chiefly of the destruction and consumption of stocks of goods and growing crops. There might be privation or indeed famine under actual war conditions,

but peace would see a renewal of production, and shortages would be made good by a single favourable season.

People of the present generation have become terribly familiar with what has come to be called Total War. There have been revolutionary developments in the organization and technical efficiency of industry and transport. Warfare has become a heavily capitalized and highly organized industry. It has become possible, as never before, to concentrate the human and material resources of a country on the single end of creating organized force for attack and defence. The material resources can be used up and exhausted to an extent that Mill and his contemporaries never dreamed of.

How has this come about? In the nineteenth century economic activity was founded on the principle of *laissez-faire*, let-do. Let-do assumed that, if everyone were free to produce, whether on his own account or by employment of others, to meet needs, and needs made themselves felt by the offer of money for goods in the open market, then everyone would be rewarded in proportion to his success in estimating the needs to be met, and producing to meet them at the lowest cost. The profit, the margin between costs and selling price, would constitute the income of the producer and similarly of the wholesale or retail trader who bought in order to sell again.

That system seemed to be securely founded in the nature of things. The trader's profit had been the motive of enterprise from time immemorial, even though the sweet simplicity of the system had been overlaid by the interferences of ancient and mediaeval governments. In the nineteenth century let-do had become articulate. Economists advised the restriction of Government inter-

ference with private profit-making enterprise to an essential minimum, in the confident expectation that effective demand, the offer of money in markets, would attract enterprise into the channels where it was most needed and most fruitful.

That principle was applied even to the waging of war. The equipment and maintenance of fighting forces involved the Government in requirements far exceeding the peace-time minimum; yet the quickest and most effective way of drawing on the community's resources for war was by buying in the market, and trusting to private enterprise to respond to the demand. To raise money for the purpose, the Government supplemented taxation with loans freely subscribed through the investment market.

The Government had to provide an inducement to producers to supply some kinds of goods in much greater quantities than in peace-time, and the inducement took the form of higher prices. But the amount of equipment demanded by the art of war for the relatively modest numbers which could be maintained in the forces was not such as to overstrain productive capacity or to push up prices to an extortionate level. The economic system could absorb the strain of the war effort without suffering dislocation.

3. *Total War*

It was the sudden scarcity of munitions experienced by both sides in the World War in 1915 that first disturbed these easy-going assumptions. Orders had been given long before to manufacturers, but, if they were to be executed in time, a big extension of productive capacity would be essential. Time was vital. But there was no

certainty that the offer of higher and higher prices would elicit the necessary extension of capacity in time or indeed at all. The duration of the war was utterly uncertain, and, when it ended, most of the extended productive power would be redundant and useless. It became clear that the Government could not be satisfied merely to offer money for what it needed; it must *take the initiative* in creating new productive capacity for warlike equipment of all kinds, and must make contact with the producers direct and not only through markets.

That system was widely extended during the course of the war, but the return of peace saw on the whole a reinstatement of let-do and profit-making enterprise.

In war on such a scale as this generation has twice experienced, no combatant can afford to limit his effort. Whatever resources *can* be made available *must* be drawn upon. Such are the hazards of modern war that no preponderance of power over the enemy can make success certain, and no mobilization of resources short of the maximum is sufficient. Anything less than the greatest effort possible risks defeat.

For the Second World War an immense extension of the principle of Government initiative became possible —possible and therefore necessary. In Great Britain coercive powers of growing severity and scope were taken, not only for extending productive capacity and directing man-power where they were required, but for limiting production which could be dispensed with. Eventually the free response of supply to free markets was restricted to insignificant proportions.

Policy has required the observance of a due balance between the standard of living of the population and the devotion of resources to the war effort. Productive power applied to one is withheld from the other.

Scarcity of civilian supplies results. But if the offer of high prices in the market is not to be relied on to attract resources into the war effort, the scarcity of civilian supplies cannot be allowed to work its normal effect of high prices. Obviously the Government cannot afford to let the offer of high prices, which it has abjured for its own needs, attract production into the rival purpose of supplying civilian needs. And, what is even more vital, an indiscriminate rise of prices of civilian supplies would concentrate the privations on those with insufficient means to procure the scarce products. A chain is as strong as its weakest link, and inequality of distribution, by exposing some individuals to more than their fair share of privation, would not only weaken the physical capacity of the community as a whole to stand scarcity, but would inevitably excite indignant resentment among the people.

In fact the intensity of demand imposed by the war effort on the resources of the community spread to civilian needs. The intensity of demand was caused in the one case by the vast extent of the requirements, and in the other by the shortage of supplies. But either way the Government had to intervene and to supersede the normal operation of unregulated markets.

4. *Controls and the Standard of Living*

The British Government in the war just ended assumed responsibility for the supply of all staple foods. Agriculture at home was heavily subsidized, and directed to the kinds of production which policy required. Those foodstuffs which had to be imported were bought by the Government from the producing countries in bulk. To keep down the cost of living, the supplies, whether from

at home or from abroad, were sold at relatively low prices, incurring a very heavy loss, and constituting a subsidy to consumers. That was possible because the rationing system prevented the low prices from evoking an increased consumption.

To some extent supplies other than foodstuffs have been similarly regulated. "Utility products" have been manufactured and put on sale by agreement with the trades concerned at the lowest prices consistent with moderate profit margins at each stage, and rationing has been extended to clothing and some other products.

These measures were applied to staple requisites, the supply of which up to a certain level was an essential contribution to the standard of living which public policy ruled to be necessary. Of other things the restriction of supplies through direct control of the home producer and the limitation of imports has been extremely severe. The supplies have been either cut off altogether, or reduced to a small fraction of the normal quantity. Products other than staple requisites have not been free from price control, but the price limits have been relatively wide. The tendency has been to consume stocks, and, in so far as price controls have been effective, stocks have been all the more rapidly depleted. When production of any article is restricted or stopped, the natural reaction of the market under let-do is to fend off demand by raising the price; if the price is limited by a control, traders find themselves deprived of the power of defending their stocks.

The Second World War has seen the conflict between the military effort and the civilian standard of living much more acute than the first. Controls have been closer and the limitation of supplies, both imported and home produced, more severe and effective. The cost of

living has been kept down by subsidies, but that has only been possible because rationing has prevented demand from outstripping supplies. Outside the sphere of rationing, consumption has been kept very short, and yet has encroached heavily on the country's stocks of goods.

5. *Impoverishment*

But it is not only stocks of goods that have been depleted. A big contribution has been made to the war effort at the expense of the upkeep of fixed wealth, including both property and industrial and commercial plant and equipment. Under peace conditions a substantial part (perhaps a tenth) of the country's entire productive resources is applied to the maintenance and necessary renewals and replacements of fixed wealth. It is so applied because the expenditure incurred, like a stitch in time, prevents deterioration which would cost far more. In time of total war, public policy rules that this productive power shall be diverted to the one all-absorbing service, the war effort, and that the property and equipment shall be neglected. Owners cannot procure the necessary labour and materials to keep their houses and household goods in good repair. In industry and transport whatever is essential to the war effort is liberally supplied and maintained; all outside it is ruthlessly let down. Thus immense arrears of expenditure on maintenance and renewals, perhaps far exceeding what timely maintenance would have cost, accumulate.

Under normal peace conditions a nation's property and equipment are not only maintained but extended and improved. This process involves capital outlay, it gives concrete form to that accumulation of wealth which is the purpose of saving. In war-time savings

are swept into the Government's net. There is capital outlay, but only on plant and equipment contributing to the war effort. The residual value of the plant and equipment which will survive the end of the war is as little considered as the long-period needs of industries outside the war effort. The material equipment of the country not only deteriorates, but becomes with lapse of time more and more deficient and obsolete.

The outcome of this diversion of resources to the war effort is *impoverishment*. It is a loss of wealth added to the vast direct destruction. And it is an impoverishment prolonging the privations sustained during the war itself for an indefinite period thereafter.

What that means is that the "war effort" is to be continued long after the end of the war. The war effort and the standard of living will still be in competition with one another. But the competition will be on a different plane; the war effort will have become an accomplished fact, no longer susceptible of being either intensified or relaxed. Its competition is to be felt as a deadweight burden. In so far as the inexorable curtailment of the standard of living is not accepted, it can only be postponed, not evaded.

6. *Post-war Priorities*

So long as the war effort is in the making, the restriction of civilian standards is a part of the effort. It releases the man-power and material resources for the creation of the organized force which is the product of the war effort.

When the war effort has finished its task, the scarcities caused by its pressure remain. Some at any rate will be serious enough to call for the same kind of controls as

the war-time needs. That is to say, the readjustment of supplies to needs cannot be relegated to the free working of markets and to the response of profit-making enterprise to the incentive of high prices. Governments which have assumed command of economic processes in war-time will be compelled for a time to retain it.

In some respects post-war scarcities will impose a more difficult task on Government controls than the war itself. The standard of civilian consumption allowed by total war was easily formulated—it was the lowest that could be tolerated. New supplies could actually be reduced below the lowest, for they could be supplemented from pre-existing stocks. The post-war problem will be the reconciliation of the competing claims of immediate consumption and the restoration of the community's stock of accumulated wealth, the goods in store and the fixed wealth.

The fixed wealth includes not only the durable equipment and fixed capital of industry, transport and business, but the houses and appurtenances which are an essential part of the standard of living of the people.

In place of the simple paramount priority of the war effort, dictating a minimum civilian standard, the aim must be the best available civilian standard. It is an aim of immense and baffling complexity. When the Government had to provide a sufficiency of staple foods for health and physical fitness, to make the best of the available housing accommodation for those not in the temporary camps constructed for the forces, and to direct a small residue of productive power into the provision of some essential clothing and other consumers' goods, the planning required, though never easy, was manageable. The most serious difficulties were not in deciding what was wanted, but in procuring

it in face of war-time difficulties of production and transport.

But when the aim is no longer the lowest tolerable standard but the best practicable, the problem of deciding what is wanted, and of making the best use of the reviving powers of supply, becomes one of extreme difficulty.

The first approach is clear enough. The provision of essential food and shelter must take priority over everything else. About that there is no controversy. The administrative machinery for the provision of food is in being; in the United Kingdom at any rate it is very effective. There are world shortages of some products, and the distribution of those of which supplies are adequate depends on the release of shipping and transport previously absorbed by military exigencies. The organizing of supplies is likely to be difficult, but the purpose is clear.

Next to food comes housing. On the urgent need not only for making good war damage, but for overtaking six years' arrears of upkeep and new building there is no difference of opinion.

Here is a service in which public authority has undoubtedly to take the initiative. It may be compared with the demand for munitions in 1915, or any other war-time service, where the public interest needs orders to be given to an industry for production on such a scale as to overtax its capacity.

If orders for the amount of production needed descend in unregulated fashion upon the industry, the result is to drive up prices; and even a big rise of prices may fail to evoke anything like an adequate increase in productive power. Accordingly, the Government must not confine itself to giving orders to such producers as are

in a position to take them; it must interest itself in the creation of the requisite new capacity. It must form estimates of the amount and character of labour and plant required, must measure up the deficiencies in every category, and must induce or direct or in the last resort coerce those who are in a position to make the deficiencies good to render the desired services.

That is the procedure appropriate to any war-time service which has to be expanded for the sake of the war effort. But there are differences in the application to peace-time needs.

Housing can claim a high priority, but not the *absolute* priority accorded to the war effort. The resources directed to building houses are directed away from other operations, and the claims of these latter must be balanced against the claims of housing. In war-time every normally constituted human being is expected to contribute what he can, however remote, to the war effort; some service will be found within his capacity, however modest. In peace-time employment is not so straightforward. What is needed is to assign to everyone some function which will fulfil a useful end. And what is a useful end? It is no longer the simple and unique aim of victory; it is whatever best conduces to the welfare of the people composing the community. Welfare is multifarious and infinitely varied.

The priority of food and housing is a recognition that they at any rate are essential to welfare; they must be the foundation on which the whole structure of welfare is to be built. The provision of food and housing cannot employ more than a fraction of the population, even in a country where the shortage is greatest. The numbers that can be employed in extracting food from land are limited, and the numbers that can be employed in the

transport and distribution of food are limited by the amount of food. The numbers that can be employed in building houses are limited in various ways. The working force must contain due proportions of workpeople of the different skills and qualifications required. Given time, ample numbers can be trained, but training calls not only for time but for qualified instructors and opportunities for practice. And it is no use organizing numbers of workpeople in excess of those for whom plant and materials can be provided.

There are other services of high priority, especially fuel and transport. Transport is essential for the supply and distribution of food and of the materials for building, as well as for all other industries. Fuel is both an important item in the standard of living, and a necessary material for transport and for a wide range of industries. Shortage either of transport or of fuel creates an urgent need. War conditions have created shortages of both. Much shipping and road transport is released by the return of the forces to a peace footing, but still there will be much to be done to re-establish anything like a normal transport system in the world. Scarcities of clothing, furniture and utensils have been met by the provision of limited supplies of "utility" products, of which price and quality are closely regulated by controls applied to every stage of production and distribution.

But when all possible weight has been allowed for priorities such as these, only a modest fraction of the available productive power will be used up in them. The greater part will still remain to be organized and applied.

7. *Post-war Needs*

That opens up a twofold problem: a problem, on one side, of employment, on the other, of the needs to be met. Given that the best practicable provision is made for food, fuel, housing and transport, and other primary needs, what other provision is to be made? The provision for these primary needs may be inadequate, but people will not be any the less desirous of satisfying other needs not so elementary. If there were no rationing system to regulate the primary needs, people with money to spare would compete for the supplies of necessaries and drive up prices, and their poorer neighbours would suffer greater privations. A disproportionate spending power would thus come into the hands of those who dispose of the available supply of the scarce necessaries. With a properly organized and regulated rationing system, the prices of the necessaries rationed are kept down. Each individual can buy no more than a fair share at a moderate price, and he has all the more of his resources available for buying other things. The power of spending on things outside the rationing system is spread over the whole community.

Either way the spending power is there, and will not be any the less used on account of the prevailing shortages of necessaries. And it is in satisfying this spending power that employment is to be provided. The continued maintenance of full employment is an aim which has become the centre of attention in the economic world, and we shall have to turn to the consideration of its wider aspects presently (pp. 52-4 below). As yet we are only concerned with the initial problem of what sort of employment people shall enter into at the transition from war to peace, when

war-time scarcities and dislocations are still being felt.

People with every variety of skill and competence, together with a large number who have been swept into the forces or into some specialized war-time employment before becoming qualified for any normal peace-time occupation, constitute a potential working force. They await the opportunities to work for the community, that is to say, to supply one another's needs.

How are they to be set to work? Work essentially means the kind of activity which helps to meet a *need.* To employ people on work, the needs to be met must be ascertained. In the simple case of staple requisites, such as food, fuel, housing and transport, the needs are obvious. The *best* ways of satisfying them are not always so easily discovered, but a public authority can safely take steps to provide an essential minimum standard, with assurance that what it provides will be really needed and will be used.

But if the working force of the community is to be fully employed, a majority will have to be employed on products which do not claim the priority appropriate to staple requisites. That does not mean mere superfluities and luxuries. There are innumerable products which confer substantial advantages of convenience or amenity, and which come between the two extremes of primary necessities and superfluities. But, along with these, superfluities and luxuries must be included.

They must be included not merely to "give employment." Indeed any employment which involves the use of scarce materials must give way to the essential priorities, even at the cost of leaving specialized skill unemployed or diverting the possessors of it to unaccustomed work.

But so-called superfluities make a very real and substantial contribution to the standard of living, and, subject to this priority where scarce materials are involved, there is every reason for continuing or resuming the provision of them. Even in war-time there is no question of reducing the standard of living to a physical minimum. Some margin, for instance, has to be allowed for recreation, entertainment and sport. Without such relief, efficiency itself would suffer; even the war effort requires it.

But the peace effort is different in kind from the war effort. Its aim is *welfare*. Of welfare due provision for primary needs is an essential condition, but the satisfaction of primary needs can do no more than prepare the ground for something more positive. Even the goods and services which are classed as conveniences are subject to this same limitation. They assist in forming the foundation of the good life, but positive welfare demands a higher structure surmounting that foundation. This higher structure cannot be exclusively economic, but economic activity can make an important, perhaps a vital, contribution towards it. Economic activity means work, and most of what is good in human life, intercourse and culture calls for work at some stage and in some form.

The plan of let-do is to let every individual make his needs felt by the offer of money for what he wants. Markets are organized to display the products put on sale, and it is for the consumer to make his choice. The producers work by trial and error, continually stocking the market with the things they hope people will like. When their hopes are fulfilled and the things are sold, the production of these things is repeated and is continued up to the limit of what can be profitably disposed

of. Products which drop out of favour cease to be produced. The consumer's choice is widened by the introduction of novelties, new devices, new patterns, new inventions, which, when successful in attracting demand, are a source of profit to the traders.

That is the system which is still the foundation of the distribution of goods. Its operation has been greatly interfered with, though never altogether suspended, during the war, and it will revive as production for civilian use revives. The consumer's choice cannot be superseded by the decisions of a central authority. In the case of scarcity of a staple product, the Government may assume control of supplies; it decides what is to be produced or imported, and the consumer's choice is thereby limited. But outside these exigencies there is no other practicable way of ascertaining needs and meeting them.

8. *Critical Deficiencies*

The meeting of needs is the essential character of production in the economic sense, and the ascertainment of needs is therefore an essential condition of economic activity. Without it "employment" is emptiness; it is a coming and going, a fussing and a chattering.

Here then are the needs, and here is the man-power, the potentiality of supplying them. But in order that the potentiality may become an actuality, much has to be done. Not only is a great part of the man-power inexperienced and untrained, but the plant and equipment have been let down, and for many industries there is a shortage of materials.

In making good these deficiencies we must look forward to the needs to be met. The traders engaged in producing and selling goods are accustomed to look

forward. Their activities depend on forecasts of the demand through which needs make themselves felt. Under normal conditions their forecasts are to a great extent guided by the existing current sales. What they are actually selling they go on producing; what they are failing to sell they stop producing. Six years of war make a breach of continuity. General shortage means a latent demand for everything, but there is no reliable evidence of the relative magnitude of the demands for different things. Yet that is what has to be estimated in restoring the means of production, whether in training hands for various industries, or in restoring, renewing and extending plant and equipment, or in providing materials.

It follows that the first step ought to be to get every industry, great or small, necessary or superfluous, started, so that the market for its products can be tested. The first deficiencies to be made good should be those which throw industries out of gear. Each industry requires factors of production in due proportion, not only labour, plant and materials, but subdivisions of these, different skills and aptitudes of labour, different kinds of plant and materials. The general shortage affects these different factors in different degrees. In every industry the immediate limit of its activity will be set by the particular factors of which there is the greatest proportional shortage. In one it will be a particular kind of skill or craftsmanship, in another some machine or tool, in another some essential material. Shortages which have this dislocating effect may be called "critical deficiencies." Failures to remedy them will keep the other factors of production in the industries concerned idle or under-employed.

Under-employment of any productive resource is just

aggravating the terrible problem of impoverishment; it is, as it were, adding to that part of the war effort which has been deferred, and which the future has to bear. From the outset the making good of these critical deficiencies will be urgent. There will be a special pressure on the means of supplying them, that is to say, on the facilities for training specialized workpeople, on the industries which manufacture or repair the plant and instrumental goods of which there is a shortage, and on the means of producing and transporting the scarce materials.

Every industry is in the hands of its own specialists and leaders, who understand its capacities and needs better than any outsiders. It is they who will be directly aware of the industry's most urgent deficiencies. If every industry were left to fend for itself, the pressure upon that part of the country's productive resources which is concerned with remedying the critical deficiencies would be applied haphazard, and there would be both exorbitant rises of prices and ruinous delays. The relative priorities of different demands would be determined not by their contribution towards the vital purpose of bringing productive power, human and material, into full employment, but by the prices which the applicants are prepared to pay. Prices would be put to a deterrent level to limit the demand to what can be supplied within a reasonable time. But in conditions of extreme uncertainty the calculations of the applicants will vary widely, and it may be that some whose need, from the standpoint of the economic welfare of the community, ought to be regarded as most urgent, would be choked off by prices readily paid by others whose claims might have been deferred with little harm.

That is to say, the unregulated operation of markets

would levy in the form of high prices a kind of tax on all those industries which are being held up by deficiencies of special factors, a tax which is designed to be prohibitive in instances sufficiently numerous and considerable to bring demand within manageable bounds, and which enures to the profit of those who are in a position to supply the deficiencies.

That, beyond dispute, is the kind of situation which needs central control. Control may be assumed to take the form of so allotting the available materials and the available training facilities for labour as to carry out a defined economic policy. And that policy ought to be to put the entire community to work as quickly and smoothly as possible. The operations accorded priority should be those relieving the critical deficiencies in *any* industry, however superfluous the needs it meets may seem to be. This control can be distinguished from that which is concerned with safeguarding the provision of staple requisites. The latter works through governmental initiative; the Government itself gives directions to employers and workmen, prescribes prices, wages and profits, rations consumers, and, where necessary, intervenes as buyer and seller.

On the other hand, the control which regulates the supplying of critical deficiencies throughout industry assumes that the shortages of necessaries are already given the appropriate priorities, and it ought to aim at giving free play to consumers' preferences and equipping industry as quickly as possible to meet them. That means taking *quick results* as the criterion in determining the relative priorities in the whole range of operations for overtaking six years' arrears of upkeep and development of the capital equipment of industry. By "quick results" we mean results in putting each

industry into production to meet needs. And it must not be forgotten that deficiencies to be met include not only those of industry, but multifarious articles to be used by consumers, and also the arrears of upkeep of property. There are not only arrears of upkeep and construction of essential housing accommodation and furniture and utensils, to which the first priority has been assumed to be allowed, but there are arrears of maintenance of amenities; there are fine houses in danger of decay, gardens which have become wildernesses, beautiful or choice possessions of all kinds threatened with the deterioration which comes of neglect. Quick results include the quick application of available resources to restoring these things to use and enjoyment.

Thus policy requires a twofold control, a regulation of the provision of necessaries which are in short supply, and a direction of the rest of the available productive resources into those operations which will soonest put the man-power of the community to fruitful work which it is competent to perform.

9. *World Conditions*

The community. What is the community? Policy is the policy of a Government, and a Government is concerned with the people it governs. But these principles apply to all mankind. For some purposes the whole world is a single community. Very nearly the whole world has been involved in the war effort, and the resulting scarcities and arrears of maintenance and renewals are world-wide. It is the entire working population of the world that is awaiting a return of economic activity. In that process international trade is

no more than an incident. The boundaries which separate one Government's jurisdiction from that of another are a complication in the application of the essential policy, but they do not materially alter its character. Different countries suffer in different degrees from the various distresses left behind by the war. In some the direct ravages of war have been on a catastrophic scale, current supplies and stocks of staple foods and essential clothing and utensils have been disastrously depleted, houses have been ruined, and the means of transport wrecked. Their need of help from other countries is fully understood. Where the havoc has been less terrible, the general economic repercussions of war have still been felt. The normal supplies of manufactured products from the industrial countries in exchange for the food and materials of the primary producers have dwindled almost to nothing. There are shortages of manufactured products in all types of countries. There is some tendency for unsold surpluses of exportable goods to accumulate in most countries owing to the shortage of shipping and other forms of transport. But the want of markets or the lack of materials has discouraged production, so that these surpluses are not a very important element in the economic situation in the world. Everywhere in fact the *potential* capacity to produce is the vital factor. If countries are to help one another, the potential production must become actual.

Unfortunately, the supply of goods from one country to another is a subject beset with complexities and difficulties. There is no field in which international jealousies are so acute. It is the meeting of needs that constitutes any human activity production, and production for export is no exception to that principle. The

meeting of needs in the importing country confers the character of production on the processes performed in the exporting country. Every country clings tenaciously to the markets abroad on which its export trade depends.

Consequently, we cannot expect that the independent countries of the world will be able to start supplying one another without arousing a searching and suspicious scrutiny, wherever former or potential exporters fear that they are being supplanted by interlopers. The finding and opening-up of export markets is a skilled and lucrative calling, characteristic of the merchant. Upon the merchants' profits derived from this source the great commercial nations of the world have been accustomed to grow rich, and by growing rich they have grown powerful. If economic policy throughout the world is to be directed to remedying the critical deficiencies of industries with a view to restoring them as quickly as possible to full production, those industries which are soonest restored will gain an advantage over the rest in exploiting markets at home and abroad.

At that first stage of the return to economic life there will be a special strain on the capacity of those industries which are called upon to *supply* the critical deficiencies. Some countries will be sources of materials of which there is a world shortage. In some the industries which manufacture the specialized mechanical equipment and instruments of production needed to restart industries elsewhere will find their productive capacity overstrained.

International provision of some kind ought to be made for distributing these supplies, so that the countries in greatest need will get a fair share. It is generally recognized that those countries which have suffered less from the effects of war and those which are favourably placed

for providing the essential supplies ought to help their less fortunate neighbours. The organization set up by the United Nations is an administration not only for relief but for rehabilitation. Relief means the provision of staple necessaries, food, fuel, transport and the indispensable minimum of clothing and utensils. But rehabilitation means especially the making good of the critical deficiencies of industry. Countries which will cheerfully send supplies as a free gift, or on credit terms which secure them something substantially less than a full equivalent, may demur to helping to rehabilitate industries which will in the future compete with their own exporters. On the other hand, when there is a serious shortage of supplies of practically everything, no producers will be apprehensive of any imminent loss of markets, and it is to be hoped that there will be an interval before the general return to economic activity which is so greatly to be desired is seriously interrupted by international suspicions.

10. *Money*

Up to this point we have been surveying the economic facts without any express reference to money. Yet of all the baneful economic consequences of war the impairment of the monetary mechanism is without doubt one of the most serious, and a brief digression to deal with the functions of money in the economic system is necessary at this point.

Money is to many people a forbidding subject, but to many a fascinating one. The study of it has, I fear, suffered both from its attraction and from its repulsion.

It is indeed difficult. The daily use of money is taken by everyone for granted, and a mental effort is needed to

look beyond its familiar aspects to the rather elusive principles presupposed by them. And economists and monetary theorists delight in flourishing paradoxes and strange inferences in the faces of puzzled inquirers.

Yet the functions of money in the economic system are neither so paradoxical nor so remote from the familiar uses of money as they are usually made out to be. The fundamental principle is that, in agreements for the rendering of services or for the sale of goods, the goods or services are *valued* in terms of a unit. A sale or a service rendered creates a *debt* from buyer to seller. A debt is an obligation recognized by law, and, in order that the obligation may be enforceable, there must be some means of discharging the obligation. A debt is discharged by *payment*, and money is the means of payment. The debt is expressed as a number of units, and the debt-paying power of money must be expressed in terms of the same units.

Coined money formerly purported to supply the means of payment in the form of a full equivalent of the obligation to be met; standard coin consisted of a valuable metal which, if desired, could be melted and used as a material of industry. If a man received a gold coin by way of payment for a service he had rendered, the gold contained in the coin was worth as much in the bullion market as the coin itself stood for. The man in the street did not melt coins and did not want to. But to bullion dealers the possibility of doing so was a very present reality, and their operations effectively assured the parity of coin and metal within a fraction.

It is the function of markets to establish values; they are the instrument of let-do for removing arbitrary inequalities of price, so that, at a given time and place, any specified article commands a single definite price.

Even in the heyday of let-do markets could never work perfectly, but under the gold standard market values in general were quite effectively linked to gold.

Except in and around the Arabian Desert the use of gold coins as a means of payment is no more than a memory, and not even a memory to those below middle-age. The medium of payment handled by the present generation is paper currency. A banknote or currency note is made *legal tender*. That means that it is established by statutory enactment as the means of payment of debts. The unit in reckoning debts in England is a pound. A debt of one pound used to be discharged by a gold coin reputed to contain 113 grains of fine gold, and is now discharged by a document inscribed with the device "one pound." "Pound" is the name of the unit. The gold coin was itself made legal tender by the Coinage Acts, which conferred on it the power of discharging a debt of one pound. The name of the coin was not a "pound" but a "sovereign." The banknote which now supplies the means of payment is a kind of ticket. As a railway-ticket entitles the holder to a journey, or a concert ticket to a seat in the concert hall, so a banknote entitles the holder to the discharge of a debt.

Under let-do people derive their incomes from the services rendered by themselves or their property to production. The things produced are sold for money, and the proceeds of sale supply the means of paying the incomes of those who have contributed to the production. A single-handed worker may sell his own work, and realize the whole proceeds as his own income. More usually production is organized by employers, who pay their workpeople a stipulated income by way of wages, and assume the responsibility for selling the

product, retaining for their own incomes the profit, that is, such excess over costs and outgoings as they can obtain.

Goods are sold for money. Where does the money come from? Evidently from the incomes derived from producing the goods. Money *circulates*. Production, taken in its widest sense, to include all the work by which people meet one another's needs outside the narrow bounds of voluntary help, generates incomes, and incomes generate the demand for goods. Indeed the money which constitutes an income, a lot of tickets for the discharge of pecuniary obligations, is in itself sterile. To bear fruit, the income must be associated with the markets to which the tickets give access. It is the purchase of goods or services in the markets which gives rise to the obligations which the tickets will discharge.

This circulation of money from production to incomes, from incomes to spending, from spending to production, is a source of the paradoxes which puzzle. The money has to be supplied by employers to their workpeople, and to those from whom they purchase materials *before* the products can be put on sale. And the money only has value in virtue of the products it will buy, yet the wages of workpeople and the prices of materials have to be settled before the products become available.

The system works because it possesses a principle of continuity. Though production takes time, the output of the productive efforts of the recent past is coming on to the market at the time when the services contributing to the production of the near future are being paid for. And the incomes derived from economic activity are not spent as fast as they accrue; the recipients are accustomed to hold working balances of

money, which they replenish from their incomes, and draw upon for their outlays.

The income and outlays of an individual will not, in general, keep pace. His cash balance represents the excess up to date of his income over his net outlays (net, because he may receive sums of money from other sources than income, from sales of his possessions, from money borrowed, from repayment of money lent, from gifts, legacies, etc.). When net outlays are overtaking income, the balance diminishes; when they are falling behind income, it increases. But over any considerable interval of time these inequalities even out, and income and net outlay should not differ materially. If we take a comprehensive view of an entire community, we can infer that at any rate under normal conditions, when the current of economic life is not subjected to any special disturbances, the aggregate incomes and outlays of all the individuals will be approximately equal. Since the incomes are equal to the value of the goods and services from which they are derived, the outlays will be just sufficient to dispose of the goods.

And this equality is not disturbed by the prevalence of saving. Saving does not mean a complete abstention from spending the sums saved. It is usual to invest what is saved. Money invested is spent on the purchase of property or securities, and, though the money may pass from hand to hand several times in the property market or the stock exchange, it ultimately becomes available for capital outlay of some kind, and so is spent. In the intermediate stages it retains its character of capital; when spent on capital outlay, it emerges as income accruing to those employed on the capital outlay.

What disturbs the equality between output and disposal of products is not saving as such, but an absorp-

tion of money into balances or release of money from them. Any one person's balance fluctuates widely, but the fortuitous fluctuations of individuals' balances in the entire community tend to average out. If nevertheless they fail to do so, and there is on balance any considerable absorption or release of money, the delicate monetary mechanism becomes in some degree disordered.

If there is an absorption of money into balances, that means that people are spending less than they receive, and the output of products is not fully disposed of. Unsold stocks accumulate, the orders given to producers fall off, so that diminished spending means diminished production, diminished incomes, and so still less spending.

If there is a release of money from balances, that means that people are spending *more* than they receive, disposals of goods exceed output, and stocks of goods have to be drawn on to meet the excess demand. Increased orders are given to producers to replenish stocks, so that increased demand means increased production, increased incomes, and still more spending.

In either case, the inequality of incomes and spending gives rise to a vicious circle. The underspending or overspending becomes *cumulative*, and the cumulative deficiency or excess of demand for products is reflected in diminished or increased productive activity. Diminished productive activity means cumulative underemployment of productive resources and unemployment of labour. Any increase in productive activity reaches a limit when productive resources are fully employed, but that does not mean an end of the disturbance. It merely transforms the process from a cumulative increase in productive activity into a cumulative increase in

prices. Producers, receiving more orders than they can execute, ask higher prices, and the output, being valued at the higher prices, provides a correspondingly increased fund out of which profits and wages are paid. Incomes, in fact, rise in proportion to prices, and spending power is generated sufficient to buy the output.

When money simply meant coin, these cumulative processes could not go on for ever. For the total quantity of money which formed the total of people's cash balances, was determined by the amount of available coin. If output and incomes shrank, the cash balances became *relatively* greater, and eventually, when many people found themselves holding unnecessarily large hoards of money, there would be a release of cash. And in the contrary case, when output expanded, prices rose and incomes were increased, people would find their cash balances insufficient, and an absorption of cash would supervene.

Even in the Middle Ages, when credit only existed in very restricted forms, money was a frequent source of difficulty, particularly the depression caused by a recurrent scarcity of money. The growth of banking and the development of credit in modern times have intensified the trouble, but have at the same time supplied methods of dealing with it.

11. *Credit*

Even in the Middle Ages merchants were accustomed to use credit as a method of settlement with one another. They met together at the great international fairs, such as that of Lyons, which were held at intervals of a few months, and at any intervening time a merchant might sell not for money down but for payment to be made at

the next fair. At the fair each merchant's debts and credits would be set off, and balances would be paid in money.

Under modern conditions the fairs have been superseded by banks. Traders hand over their money to banks, and make all their major payments by drawing on their bank balances. A bank balance is simply a debt due from the bank to the customer, and a cheque is an instrument for assigning the debt to a different creditor.

Thus the banking system is essentially a device for enabling debts to be settled by being set off against one another. And it enables people to hold "bank credit," debts due to them from banks, *instead of money*. Provided they can always convert their bank balances at need into hand-to-hand currency for minor payments, bank credit is an adequate substitute for money.

If therefore the supply of money runs short, it can be supplemented by a creation of bank credit. How is bank credit "created"? In general, by a lending operation. When a bank lends to a customer, *two debts* are created, the customer's debt to the bank (an advance or overdraft for which the customer pays interest, or the discount of a bill) and the bank's debt to the customer. The latter can be used by the customer as a means of payment; for his purposes it counts as money.

And, if the supply of money becomes excessive, the banking system can apply a corrective, not merely because an individual whose outlay falls short of his income may use the surplus to repay money borrowed from a bank, but because banks can limit their fresh lending. A banker is under no obligation to lend to his customers. If he lends too much, they will draw upon him for the payments for which they have borrowed, and

his cash reserves will be depleted. He can refuse to lend, or, if that is too drastic, and is likely to embarrass his customers, he can persuade them to reduce their requirements, and, by charging higher rates of interest on the advances he allows, he can give them an inducement to do so.

This method of regulating the supply of bank credit became highly developed in the course of the nineteenth century. It became centralized when the banks took to depositing their cash reserves with a central bank, and replenishing these reserves when necessary by borrowing (directly or indirectly) from the central bank. The precedent was set by the Bank of England. With the power of issuing banknotes, the Bank of England could by lending create money at its discretion. So long as banknotes had not wholly superseded coin, this power of creating money was subject to a limit. When the expansion of the supply of money gave rise to an increased demand for hand-to-hand currency, the Bank of England's gold reserve was drawn on for gold coin. If the reserve seemed to be dangerously reduced, the Bank would restrict its lending. By refusing to lend it could stop creating money, and reduce the supply of money as fast as its past loans were repaid. But experience showed that an absolute refusal to lend might have disastrous results. The Bank had become the lender of last resort; it alone could provide the means of payment when all other lenders were involved in the embarrassments of a financial crisis. If it refused, solvent debtors might default for want of ready cash, and each debtor's failure would bring down others, till the whole credit system might be ruined.

The Bank of England therefore resorted to milder treatment; instead of refusing to lend, it charged higher

rates of interest on its lending; it raised "Bank rate" (the rate at which it would discount bills of exchange). If the other banks were short of reserves, they would not be deterred from replenishing them by a high Bank rate, but they would certainly pass on the high rate in the interest they would charge to their own customers. In virtue of its power of creating money, the Bank of England could dictate the rates charged for the lending of money throughout the credit system. High rates would operate everywhere as a deterrent on borrowing, and any banker whose customers did not sufficiently reduce their borrowing would find himself losing reserves, and would have to restrict his lending by persuasion or refusal.

A high Bank rate has been found fully efficacious in restricting the supply of money. It should be observed that what has to be restricted is the *flow* of money: the flow of money originating from *production* in the form of *incomes*, and from incomes passing into *outlays*, and so into the *disposals* of things produced. When the assets of the banks (formed mainly out of their lending) are less, the outstanding amount of bank credit is equally reduced, but the primary purpose of a restriction of credit is not the reduction of the outstanding amount but a contraction of the *flow*. An excess of money consists in an excess of the flow of money over the output of products at the existing price level. When production cannot be further increased, the excess ofmoney depletes stocks of goods or raises prices or both.

The restriction of credit operates directly on the flow of money. It puts pressure on intending borrowers to *postpone* the transactions for which they needed the money. Dealers in goods postpone replenishing their stocks, and give reduced orders to producers; producers

postpone buying materials; those who project new enterprises or capital extensions avoid incurring expenditure, in advance of raising capital in permanent form. There is thus a general cutting down of immediate expenditure, and of the incomes which such expenditure would generate.

The deadly effectiveness of a restriction of credit in curtailing the flow of money, and enforcing a reduction of productive activity, has given rise to an obsession in the economic world, a dread of "deflation." A high Bank rate, "dear money," is the sign of a policy of contracting the flow of money. That might theoretically be accomplished consistently with undiminished productive activity and employment, if wages, prices and profits could all be reduced in proportion. But the reduction of wages is only brought about by the pressure of unemployment. And in practice wages resist reduction even when unemployment is severe; no one can estimate the extent of the reduction in wages required, and, when the pressure passes, the restoration of wages may cost a struggle. Thus in practice the restriction of credit means *deliberately causing unemployment*. Hence the odium attaching to deflation.

Moreover, there is a possibility that the vicious circle of deflation, once started, may be very difficult to break. When producers and traders have been persuaded to postpone their activities, and the demand for everything has fallen off, it may be that they cannot be tempted to resume enterprise even by a willingness of the banks to lend money on the most liberal terms. Business gets into a rut, and stagnates.

12. *Money under War Conditions*

What is the effect of war on the money system? The use of money as the medium in economic relations remains. Compulsory services and requisitioned goods and property are paid for in the same way as services or goods procured under the conditions of the open market. The Government has to raise money for the purpose. The expense of total war far transcends what can be raised by taxation. The Government can supplement its tax revenue by borrowing, and up to a point people can supply the means of lending to it by saving out of income, that is to say, by abstaining from spending, and by voluntarily accepting a lower standard of living than their incomes would allow. But however much they save, and however low the standard of living may be reduced, it is still possible for the Government to find *further* resources by encroaching on stocks of goods, and on the upkeep of property and industrial plant.

The money system provides it with the means of doing so. The banks can create credit by lending to the Government as well as by lending to traders. When the money raised by tax and loan falls short of the war expenditure, the gap can be filled by borrowing from the banks. Thereby bank credit is created and, so far as may be required, banknotes to serve as hand-to-hand currency. The Government is supplied with the means of payment, and uses it to pay the incomes of all those contributing to the war effort, the pay of the forces, the cost of administration, and the wages and profits of those producing supplies, equipment and transport.

Incomes are swollen by the amount of bank credit and money thus created. What then of outlays?

Expenditure on consumption is limited to the available supplies, but the consumers' outlay includes the taxes paid and the sums devoted to investment. Investment in time of war consists almost exclusively of contributions (direct or indirect) to Government loans. If people invested all that they did not spend, there would be no increase in their cash balances. But the saving that takes place in war-time is to a very great extent caused by the restriction of opportunities of spending. The money so saved is more likely to be held ready for future opportunities of making up arrears of spending than to be tied up in investments.

If saving means excess of income over spending on consumption, the accumulation of idle money for want of objects of expenditure during the war must be included in saving. But, in so far as it represents postponed expenditure, it is an ephemeral kind of saving. Even much of the money invested in Government securities may be only awaiting opportunities of spending. People looking forward to heavy expenditure, on arrears of upkeep of property or plant, for example, may think it worth while to put their reserves of money in Government securities, yielding interest, rather than leave it idle. That is one reason for the preference for securities such as National War Bonds, which, being repayable in a few years, are not likely to depreciate very much if sold before maturity to raise cash.

13. *War and Inflation*

In the First World War there was very little control of prices in England or America. The average level of prices more than doubled before it was over, and a further big rise followed in 1919–20. The redundant

money created during the war was let loose, and the resulting pressure of demand forced prices up.

In fact, this rise of prices (which was accompanied by a nearly proportional rise of wages) was such as to make the supply of money no longer redundant. People tended to hold cash balances proportional to their increased income and outlay. A rise of prices and wages to that limit is one way of restoring monetary equilibrium. But to it there are grave objections. In the first place the rise of prices represents a fall in the wealth-value of a given sum of money, and those who have invested their money in Government securities find that they have lost so much in terms of real wealth. If one who has lent £1,000 to the Government during the war finds that prices have since quadrupled, his £1,000 has been reduced for purposes of spending to the equivalent of £250. At a time when millions of people have been urged on patriotic grounds to save and to lend their money to the Government, such a degradation of money looks very like a gigantic swindle. And it should be borne in mind that it is especially the small investors who suffer, for wealthy men are likely to diversify their investments with holdings of shares and property, which do not depend for their value on the value of the monetary unit. The dividends paid by a company increase when the prices of the things it produces increase, and the value of the shares rises in proportion.

And it is not only war loans, but all forms of indebtedness that are affected. Monetary inflation shakes the very foundations of economic life. Wages and wage-settlements go into the melting-pot, and new bargains have to be made under conditions of baffling uncertainty. Rents are either stereotyped by leases at figures which become much too low, or are liable to be raised

to levels which in some cases will appear exorbitantly high. Life insurances and annuities which were planned to secure a competence turn out to be utterly inadequate.

Most of Europe underwent this disastrous experience after the First World War. Once the wealth-value of the unit of money has begun substantially and unmistakably to fall, people lose confidence in it and avoid holding more of their resources in the form of money than they can help. There is a "flight from the currency"; everyone hastens to spend his money on goods, property, shares, any "real values," which will rise in price when money depreciates. The flow of money corresponding to a given stock of money is enormously increased, and the fall in the wealth-value of money is thereby exaggerated into an utter collapse, to the extent of which no limit can be put.

The collapse of the German mark in the years 1919–23 was only the most most sensational of many such catastrophes. The new Reichsmark was actually the equivalent of 1,000,000,000,000 of the old. This monetary collapse had much to do with that dislocation of German economic life which prepared the way for Hitlerism. The immediate occasion of the political madness of 1933 was the intense deflation, depression and unemployment which had tormented the country since 1930, but the inflation ten years earlier laid the foundation for it, and incidentally also contributed to the depression since the dread of a recurrence of the inflation stood in the way of monetary expedients for the relief of the deflation.

No deep acquaintance with the niceties of monetary theory is needed to see the dangers of a superabundance of money, a great excess of cash balances over what

people think to be reasonably required for their current receipts and disbursements. The excess is potential spending power, which, if actually spent, swells current net outlays above current earnings. The disposals of goods by sale to purchasers exceed output. If prices are successfully controlled, stocks of goods are drawn upon, and, when stocks are reduced to a minimum, the excess money is perforce held idle. That works under war conditions, when supplies of unrationed goods are so exiguous that it is not worth while to hunt from shop to shop in search of them and to pay apparently exorbitant prices for them when found. The high prices, so long as they are attributed to the known scarcity of the desired goods, and are thought to be exceptional and temporary, deter people from buying anything they can do without. But if, when normal production is resumed, the high prices continue, and are seen to be due to an excess of money, expectation will be rather of a further rise of prices than of a fall. Instead of holding back their money and postponing their spending, everyone will hasten to spend before the money depreciates further in terms of wealth.

If that state of mind became prevalent, a restraint of inflation by price controls would be extremely precarious.

Moreover, price controls do not of themselves cure the disorder. The redundant money remains in existence, a perpetual threat to the monetary system. How is that threat to be removed? The credit system evolved in the nineteenth century checked inflation by means of a high Bank rate, "dear money." But under post-war conditions, when the Government has become the principal borrower from the banks, and the redundant money consists of bank credit and banknotes against which the

assets held by the banks are Government securities, nothing that can be done to deter commercial and private borrowers will be an effective remedy. Even a complete liquidation of all bank advances to borrowers other than the Government would be no more than a step in the right direction, and it would involve such acute embarrassments to the borrowers that it could hardly be contemplated.

14. *The Problem of Redundant Money*

Clearly an extinction of a substantial part of the Government indebtedness is what is required. High taxation helps, but it can only work slowly. There are limits to what the fiscal machine can accomplish, or the taxpayer will tolerate.

But it is not Government indebtedness in itself but Government indebtedness *to banks* which is the source of danger. If the Government can raise fresh loans from investors other than banks, and use the proceeds to extinguish its indebtedness to the banks, it will extinguish an equivalent amount of bank credit, and, provided commercial and private borrowing from the banks is sufficiently restrained, the redundant money will have been eliminated.

That might work. But only if the holders of the redundant money could be induced to subscribe to the loans. If there were no arrears of spending to be made up, there would be a chance of their being so induced. To the individual an unwontedly high bank balance ordinarily represents saving available for investment; he may hold it up if there seem to be no favourable openings for investment, but he can readily be tempted to place it in securities or property by some concession

on price. The offer of a Government loan at an attractive yield might be a sufficient inducement.

If, however, the spending of the redundant money is already beginning, and sales of goods increasing, there will be favourable opportunities to invest money in enterprise, expanding productive capacity to meet the increased demand. The yield of Government loans must be made attractive enough to divert the investors' money from these opportunities. In fact, the bare interest on the loans may have to be high enough to compete successfully with prospects of profit-making.

And the pressure of arrears of spending must make the attraction of money into Government loans still more difficult, and probably quite impracticable. The individual holders of the redundant money do not regard it as *saving*. So much of it as is destined for the deferred spending is not available for investment at all, or, if invested, has to be in some readily realizable form.

Thus the community is not only impoverished but is in possession of a superabundance of money, and the excess of money is a more immediate danger than the lack of wealth. So long as the excess of money exists, all the plans and controls devised for dealing with the shortages will be incomparably more difficult to administer and enforce.

15. *A Forced Loan*

How then can the excess of money be corrected? In 1919 the newly established Republic of Czechoslovakia inherited its share of the inflated paper currency of Austria-Hungary. The symptoms of uncontrollable inflation were beginning to appear. In that part of Europe bank credit played a relatively subordinate part

in the monetary system, and the paper currency constituted the principal means of payment. An ingenious emergency measure reduced the paper currency in circulation by one-half at a single stroke. All the people had to hand in all the paper money they possessed to offices appointed all over the country for the purpose, and they received the notes back cut in half. One-half of each note retained the character of money, but only for one-half of its face value; the other half entitled the holder to a bond participating in an interest-bearing Government loan likewise equivalent to half of the face value. Thus half the currency in circulation was transformed into a forced loan.

The money withdrawn had to take the form of a loan and not a tax, for a tax assessed on the amount of money held by the taxpayer would be flagrantly unjust. The proportion of a man's wealth held in the form of loose money at any moment is a matter of chance; a rich man may often hold no more than a little pocket money; a poor man may hold nearly all his resources in a hoard of money. Anyone is likely to hold a relative by considerable amount of money just before a large payment or just after a large receipt. If half his money is sequestered, and he receives the *full equivalent* in the form of Government securities, he may be embarrassed by finding himself short of ready cash, but he does not suffer confiscation. As much money might be raised by a capital levy as by a forced loan, but the assessment of a capital levy on the taxpayer's total resources is a matter of immense administrative complexity and is bound to take a long time; the assessment of the forced loan in Czechoslovakia in 1919 was done automatically in a week.

The Czechoslovak plan has been recently followed in

Belgium; a new issue of notes had been prepared beforehand, so that the crude device of cutting the old notes in half did not have to be employed. A very large reduction in the amount of paper currency was effected, and a very material contribution was made towards the return of the country to monetary and economic stability.

Other countries have resorted to mass withdrawals of currency, for example, France, Holland, Czechoslovakia and Finland. But in some instances the money withdrawn has been simply blocked or frozen, and the owners have neither been given interest-bearing securities nor assured of the ultimate return of their money. In the absence of any acceptable equivalent for the money withdrawn, there is a danger that the measure may cause a ruinous loss of confidence in the currency.

16. *Credit Restriction after a Forced Loan*

If this treatment by forced loan were to be applied to the United Kingdom, it would be essential to include bank credit as well as paper currency in the scope of its operation. If, say, half the paper currency and bank credit had to be extinguished, there would be an exchange of the existing Bank of England notes for a new issue of notes to the value of half each holding, together with documents entitling holders to Government interest-bearing stock equivalent to the other half. At the same time every bank would cancel half of every customer's credit balance, and credit him with the equivalent in stock.

What! Are we then to penalize the people who have saved their money? That would be a complete misreading of the measure. Those made to contribute to

the forced loan would be those who had kept their money loose and ready for spending, not those who had placed it in Government securities or savings banks. And even they would not be penalized for they would receive securities equivalent to their money. Moreover, the very purpose of the forced loan would be to *preserve* the value of money.

Undoubtedly, many people would find themselves short of cash, and some would be urgently in need of making good the shortage by borrowing or by selling securities. They would not necessarily sell the newly created stock; any marketable securities would do. It would be a mistake to put obstacles in the way of raising money. People should not feel themselves at a disadvantage through their loose cash being tied up. Bankers should grant advances to their customers and the new stock should be saleable in the market. But, if a renewal of inflation is to be avoided, there must be some *deterrent on excessive borrowing* from the banks.

Banks have sometimes tried to "ration" credit or to discriminate between more and less deserving borrowers, but as a method of limiting the total amount of credit created, that has been found ineffective. The borrower for an undeserving purpose can often so present his affairs that his immediate need of cash is for an unexceptionable transaction. Or, if he cannot, he may resort to expedients which by their repercussions are likely to land a potential deserving borrower in a temporary shortage of cash.

The deterrent must in practice be applied to all borrowing impartially. And that means that the traditional instrument of Bank rate must be employed. Borrowers must be induced by a high short-term rate of interest to limit their demands. Banks can assist the

effect of "dear money" by refusing undeserving loans and by exercising persuasion on customers, but the high cost of borrowing must be the primary deterrent.

17. *Deflation and an Expansionist Policy*

"Dear money," it may be objected, is not practical politics. It is the policy by which deflation, trade depression and unemployment have been caused in the past, and it has become odious in the eyes of all. Here, however, there has been much misconception. Dear money, like the brake of a vehicle, may cause a severe jolt or even a disastrous smash if misused. But a brake is indispensable.

The modern banking system grew up with the memory of the calamitous experiences of inflation in the eighteenth century—John Law's Mississippi Scheme, the American Continental Currency, and the French Assignats. The only monetary system which claimed to be sound was a metallic currency, coins of gold or silver. Unsound currency was taken to mean a lapse from a metallic standard, a fall of a paper currency to a discount in relation to its nominal value in coin. The deflation which prevented such a lapse counted as virtuous. The Bank of England and the central banks modelled upon it throughout the world regarded the application of deflationary measures in case of need as their primary duty. At intervals during the century preceding 1914 such measures were in fact resorted to, and were invariably accompanied by outbreaks of unemployment.

Tradition came to identify sound finance with the unflinching application of deflationary measures in spite of their injurious consequences. The reaction against it

at the present day springs from a failure to understand that the deflationary measures have been employed as a corrective of a *preceding monetary expansion which has been allowed to proceed to excess.*

A metallic currency may inflict deflation on the community simply because the supply of newly mined metal is insufficient to provide for the necessary growth of the monetary circulation. And it is undesirable to adhere to a gold standard unless that contingency is guarded against.

But it would be a mistake to attribute past epidemics of unemployment to a "shortage of gold." The shortage of gold which gave the signal for deflationary measures was merely the symptom of an excessive monetary expansion. Had monetary expansion always been kept within bounds, the contraction would have been avoided. Discussion of a long-period policy of full employment would not be germane to the post-war economic troubles which form my present theme. But I may say that in my opinion full employment is most effectively attained by a judicious regulation of the flow of money through the mechanism of credit, and especially by restraining *in time* any such expansion as is likely to involve a subsequent contraction.

The policy of full employment has come to be identified with an "expansionist" policy. It is recognized that full employment depends on the flow of money. As the Coalition Government's White Paper on *Employment Policy* (Cmd. 6527—May 1944) puts it, "assuming a given level of wages and prices, and full mobility of labour, workers will lose or fail to find full employment because there is not a sufficiently large expenditure on the goods and services which they might produce. If more money is spent on goods and services, then more

money will be paid out as wages and more people will be employed" (par. 40, p. 16).

The expansionist policy which is recommended is a policy of *expanding the flow of money*, and so long as there *is* unemployment, that is the right treatment. But there must be a limit to expansion, and the limit ought to be recognized when full employment is attained, and any further expansion of the flow of money will simply raise prices. Unless expansion is to exceed the limit, there must be some means of restraining it.

The prevailing hostility to dear money is wholly due to the fact that dear money is effective for that purpose. A high short-term rate of interest checks expansion, and, if persistently applied, causes a contraction of the flow of money. But if applied *in time*, so that the expansion is prevented from becoming excessive, the check need never develop into a positive contraction.

In 1919 an expansionist policy was pursued, and there was full employment. Early in 1920 the monetary expansion was generally recognized to be so extravagant that it must be stopped. Bank rate was put up to 7 per cent, and a violent deflation followed, bringing the number of unemployed at the end of 1921 to two million. Had the expansion been stopped as soon as full employment was reached, that is, in the autumn of 1919, there need never have been any contraction.

It is often taken for granted that every war must be followed by a trade depression. But on the contrary the sequel of war is a shortage of goods and a superabundance of money threatening to cause an *excess of activity*. If, nevertheless, there is to be depression, it will be because the latent spending power will have been let loose, and expansion will have gone to such lengths that a drastic corrective will be universally recognized to be

an urgent necessity. As the White Paper on Employment Policy pointed out (par. 19, p. 10), "our main problem for a considerable time to come may be, not to avert mass unemployment, but to secure with a limited labour force an adequate production of the goods needed to improve our standard of living and to increase our export."

The White Paper recognized the need to prevent "an inflationary boom—bringing with it the social injustice and economic disturbance which inevitably accompany inflation" (par. 16). But on the means of preventing it the recommendations offered were very inconclusive. They took the form rather of an appeal than of a policy. Rationing and Price Control would have to continue, but would not be effective unless employers and workers would "exercise moderation in wages matters" (par. 49). All must "work together to keep the level of internal costs down" (par. 16). "The habit of saving must still be encouraged."

Without control the arrears of capital expenditure would cause "a scramble to borrow, leading to a steep rise in rates of interest. The Government are determined to avoid dear money for these urgent reconstruction needs." Therefore "access to the capital market will have to be controlled in order to ensure the proper priorities" (par. 16).

18. *Dear Money*

Later on, on the other hand, "the possibility of influencing capital expenditure by the variation of interest rates will be kept in view" (par. 59).

The implication is that dear money may be relied on under normal conditions to check an excessive expan-

sion, but that it is *not* to be used in the post-war transitional period. Surely a terrifying prospect! At no time could an effective check on excessive expansion of the flow of money be more imperatively needed than just after the war. *Any* measure for reducing the flow of money will need to be supported by some method of preventing a renewed expansion through a too liberal creation of credit. An expansionist policy which is to forgo any such preventive will fatally repeat the disastrous blunders of the years 1919–22.

There is, I think, some misunderstanding about the working of dear money. The White Paper describes interest rates as "influencing capital expenditure," and records a determination to avoid dear money for the "heavy arrears of capital expenditure on buildings, plant and equipment . . . and construction or new development" (par. 16).

But dear money in relation to monetary policy means a high *short-term* rate of interest, the rate charged on bank loans and overdrafts, which responds to changes in Bank rate. Capital expenditure financed by long-term borrowing or by issues of shares is influenced by the *long-term* rate of interest, of which the yield of Stock Exchange securities is the measure.

A project for capital expenditure may indeed be postponed on account of a high rate of interest on bank advances, for the intention may be to borrow part of the money required temporarily before any permanent arrangement is made for raising the requisite capital. Moreover, a credit stringency causes a temporary fall in the prices of securities, which, though the effect on the ultimate financial outcome of the enterprise be negligible, may yet justify waiting a few months in the hope of a more favourable market for a capital flotation.

Thus the essential effect of dear money, in the sense of a high rate of interest on bank advances and similar temporary lending, is to cause a *postponement* of borrowing. The borrowing most affected will be that most easily postponed, particularly the purchase of goods to replenish stocks, whether wholesale or retail. A project of capital outlay can be postponed while it is no more than a project, but, once practical preparations for it have been put in train, postponement becomes difficult, and at any given moment the amount of capital outlay in the community as a whole that can be conveniently put off is likely to be relatively small.

In fact, a high Bank rate is an instrument, not for checking capital outlay, but for checking the *creation of money*—money taken in a broad sense to include bank credit as well as currency.

19. *Prices and Wages*

A really effective control of prices, so long as it lasted, would prevent any active inflation, provided wages were kept down. If wages go up, prices have to be allowed to rise so far as to cover the increased costs. During the war price control has been tolerably effective. There has been no actual wage control, but it has been possible, by subsidizing the cost of living, to keep the rise of wages within limits. So long as wages reckoned in money are kept steady, the fatal step to inflation has not been taken. The price of human effort or a man's time is the ultimate measure of any standard of value. That is also the measure of costs. If prices outstrip costs, traders receive swollen profits; they can then stand a reduction of prices which leaves them with normal profits, without being involved in a trade

depression (provided they do not *expect* a further fall).

But if prices outstrip costs, there is imminent danger that wages will rise and remove the disparity. On the one hand, the rise of prices increases the cost of living, so that a given money wage represents a lower real wage. On the other, workpeople are likely to claim a share of the employers' profits. Excess profits may be taken away in whole or in part by taxation, but that makes it all the easier for employers to make wage concessions with little or no immediate loss to themselves.

The subsidies in aid of the cost of living have made it possible to keep increases of wages within bounds. They may be regarded as the principal existing safeguard against a precipitate inflation. But they are negative taxation. Whereas with one hand the Treasury strives to restrict spending power by extending direct taxation to many millions of low incomes, with the other it *increases* spending power by supplying staple requisites at low cost. The cost of living, when referred to in wage contracts, means the official index based on staple requisites, such as food, fuel, clothing and rent. But the cost of living which confronts the wage-earner comprises all things on which he actually spends, however superfluous economic theory may deem them to be. The items of all kinds which are put on sale for consumers, exhibited in shop windows and shelves and listed in catalogues, number hundreds of thousands. With their wide yet sometimes elusive variations of quality and type, they defy price control. Yet the price-level of this vast miscellany of supplies, into which, when the goods become available, every hand, rich or poor, will dip, cannot be ignored in estimating the standard of living. It cannot be assumed that an indefinite rise

in the prices of all things other than staple requisites will be acquiesced in.

Perhaps it may be contended that price control can be applied to them, and at any rate ought to be tried. The war-time price controls outside rationed products and utility products have not been inoperative. If they have not prevented very high prices of many articles, that has been attributable rather to the elasticity of the Acts under which they have been administered than to evasion or disregard of the controls. A rigorous price control covering *all* goods and services, including those involved in capital outlay, would deprive people of any opportunity of spending any more of their money than would pay for the available supplies at the permitted prices.

If the control were not only effective, but universally expected to continue effective for an indefinitely long future period, would not the holders of redundant money eventually invest it in Government securities? Investment in private enterprise would be limited, no less than expenditure on current needs, by the productive capacity of industry combined with the limitation of prices.

But if people were free to spend all their loose money, an effective price control would mean a chronic exhaustion of stocks of goods. Incomes would buy up the whole of current production, and the redundant money would reinforce spending power so as to exhaust even those stocks which have not been depleted during the war. Consumers' stocks as well as traders' stocks are short. Retail and wholesale dealers would give orders to producers for goods in excess of their sales in the hope of reconstituting their stocks. But production generates incomes equivalent to output, and, if the

incomes are spent, the entire output is disposed of, and no addition to stocks results. To bring about any addition to stocks, a portion of the community's savings must be specifically appropriated to the purpose.

Under the working of let-do traders make good a shortage of stocks of any commodity by charging a price exceeding the replacement value by more than the normal margin of profit. The high price staves off demand, and keeps down sales to something less than new output; in effect the traders *save* the additional income derived from the extra profit margin, and devote the saving to accumulating the desired addition to their stocks.

Price control prevents this procedure. A trader who wishes to accumulate a stock can only defend it against current demands by refusing to sell at the controlled price. But a refusal to sell at the controlled price would be a breach of the law administered by the control. If it were not, it would obviously open the way to undesirable abuses. There would be favoured customers, and the price of favour would be sure eventually to take pecuniary form; it would in fact be an evasion of the price control.

And, once evasion has begun, it spreads. The trader who sees his competitors making far higher profits than himself by obliging their customers, and at the same time accumulating a much-needed stock, will soon find his scruples evaporating. And people who see their neighbours buying what they need without difficulty, and at a cost, though high, yet tolerably within their means, will soon learn to do the same.

If there were no shortage of goods, price control would be unnecessary. When there is a shortage, price control prevents the shortage from ever being made good.

20. *Limitation of Capital Outlay*

There will be savings, it may be said, and cannot the savings be directed to accumulating stocks instead of to new capital outlay?

Traders, it is true, may raise fresh capital expressly for the purpose of holding additional stocks of goods, and individuals may invest their savings with them. But if these resources are diverted from capital outlay, nothing is gained, unless capital outlay is so far reduced that it does not exceed the residue of saving out of income. Total new production, to meet current expenditure and capital outlay, is always equal to the total incomes generated. The danger of redundant money is that it permits of current expenditure and capital outlay exceeding the total of incomes, and therefore exceeding new production. The excess can only be satisfied from stocks. Thus an excess of capital outlay over the saving available for it results in an equivalent loss of stocks, and the diversion of savings to the accumulation of stocks is in the end of no effect.

Even when the redundant money is extinguished, the possibility of replacing it by a too liberal creation of credit holds over the monetary system the threat of potential spending power, straining the productive resources of capital outlay as well as of consumable goods.

Even apart from the arrears of capital outlay, the demand for consumable goods affords a powerful inducement for *extending the capacity* of the industries supplying them, and extension of capacity means additional capital outlay, especially when labour is scarce and labour-saving plant is technically possible.

Price control is difficult to apply to capital outlay.

Some items are readily amenable to it, such as machines and appliances which are put on the market in standardized types. But capital outlay often takes the form of complex installations, each of which is unique and cannot be priced by reference to any standard. Even costs do not supply a standard, for the necessary costs cannot usually be assessed except by means of surveys and estimates which only the contractors themselves are competent to conduct in full detail.

Capital outlay, on the other hand, can be restricted by licensing. The production exacted from the industries undertaking capital outlay can be so limited as to be within their capacity, and the pressure on capacity which raises prices may be thereby avoided. The same restriction could keep the resources currently applied to capital outlay within limits, so that savings do not have to be supplemented by drawing on the redundant money, and it is only by just such a restriction on the outlets for capital expenditure that the long-term rate of interest can be kept down. Is not this a complete solution of the problem?

Given an effective limitation of capital outlay, the problem of preventing inflation by means of controls would be confined to preventing the spending of the redundant money on consumable goods and services. The remaining obstacle would then be the shortage of consumers' own stocks of consumable goods.

That shortage, however, is even more intractable than the shortage of traders' stocks. To the individual an insufficiency of the things in daily use, and of the reserves of them which he is accustomed to hold for unforeseen contingencies, have the first claim on his available funds. Till that claim has been satisfied, he cannot be induced to tie up his money.

The only effective solution is *to extinguish the redundant money*, and to impose an adequate deterrent on reintroducing it by way of a creation of credit through bank advances. Taxation would be too slow a method of extinction. The biggest surpluses to be hoped for from ordinary taxes would take many years to complete the process. A capital levy would involve prolonged delay in assessment, and would probably take a long time to collect. I do not think a capital levy on such a scale as would be required has ever been successfully put through. A forced loan would seem to be the only measure by which money can be extinguished on the great scale required and *in time.*

21. *The Rate of Interest*

But, whatever measures are employed to extinguish the redundant money, the deterrent on the creation of bank credit is essential to prevent a recurrence of inflation.

Is dear money the only practicable deterrent? If capital outlay can be limited by licensing, cannot consumption outlay be likewise limited by some administrative device? A considerable part of it is already limited by rationing, and groups of commodities can be dealt with by point rationing.

No such device for dealing with all commodities and services is in sight. The menace of inflation cannot wait. Nor is there any reason to suppose that a system of super-rationing, comprehensively limiting people's freedom to spend their own money, would be in any way preferable to a summary extinction of the redundant money with the subsequent support of high charges on bank advances. "Dear money" is feared only because it is effective for its deflationary purpose. But it is itself

a *mitigation* of the absolute refusal to lend, to which the Bank of England, till a century ago, had recourse in order to prevent the creation of too much currency.

A direct limitation on the consumers' freedom to spend, if a practicable method of applying it were devised, could only be another way of producing the same deflationary effect. And it could hardly be capable of such delicate adjustments at short intervals as Bank rate.

A high short-term rate of interest does not necessarily involve a high long-term rate. Short-term borrowing may be resorted to, it is true, in the form of bank advances, for capital outlay, and, if such borrowing is discouraged, the resources available for capital outlay are so far diminished. But, if in any case capital outlay is to be limited by licensing and by the allocation of scarce materials, it can be kept within the bounds of the resources available, without any aid from bank advances. So long as there is no shortage of resources in the investment market, there will be no rise in the long-term rate of interest.

The case commonly made against a high long-term rate of interest is that it retards desirable reconstruction and development by discouraging capital outlay, that it causes deflation if the deficiency of spending on capital outlay fails to be made up by an equivalent spending on consumption, and that it increases the burden of national debt interest on the budget. But when there is urgent need to prevent the exceptional pressure of reconstruction and development causing inflation, the two former of these three grounds do not apply. Indeed at all times it is desirable that current capital outlay should just keep pace with current saving, and it is the function of the investment market (working

through the Stock Exchange) to maintain the balance between them by adjusting the cost of raising capital (the yield to the investor, representing the interest paid by the borrower). Short-term bank advances to reinforce the resources of the market should be no more than an expedient to tide over a temporary deficiency of savings.

Lord Keynes has offered the economic world a different version of the working of the capital market. He holds that there is likely to be a conventionally normal long-term rate of interest, and that, when the actual yield of securities at their market price falls below this standard, people withhold their money from investment and prefer to keep it idle. If that were so, an indefinitely large amount of money might be voluntarily held idle. The underlying assumption is that openings for investment which are remunerative at a higher rate of interest do not exist, an assumption entirely alien to the conditions which must prevail for many years while the destruction and arrears of maintenance, renewal and extension of capital and property due to the war are being made good. The true yield of capital outlay must be very high when it is required to make good deficiencies of plant in a profitable going concern, or to prevent disastrous deterioration of property, and the terms on which people are willing to raise capital or borrow for those purposes will be far above the conventional rate of interest.

Lord Keynes's view assumes also a "propensity to consume," which would normally be a proportion of income, leaving an unconsumed margin of saving. But in post-war conditions we have to take account of people who have perforce accumulated an idle balance of unspent money, while they are going short of clothes,

furniture, household equipment, and unnumbered conveniences and amenities, and perhaps have seen houses and other property deteriorate for want of labour and materials. For anyone in that situation the propensity to consume may far *exceed* his income. He may be in a position to spend double or treble his income month after month, and, if he is prevented from doing so, his propensity to consume may remain thus above his income for years.

A country suffering from the curse of redundant money is on the edge of an abyss. There is no sure way to safety short of the extinction of the redundant money. Equilibrium might be regained by letting the redundant money loose, and acquiescing in a rise of prices and wages which will ultimately bring the flow of money into due proportion with the stock of money. But that process is almost certain to cause a distrust of money and a riot of spending, which will quickly raise prices and wages far above this level, and bank advances and the creation of credit and of currency will be almost automatically adjusted to the higher level. To this vicious circle there is no end, as experience has proved again and again. It can only be broken by some positive and drastic intervention.

22. *Wage Policy*

There is a distinction between the controls devised to prevent inflation and those devised to tide over scarcities and privations. The former interfere with transactions, the latter with production and consumption. The former regulate the price-level or wage-level as a whole; the latter keep down the relative prices of those things which are scarce. The former would restrict capital outlay as

a whole; the latter would discriminate between different projects of capital outlay as more desirable or less so.

One is a precaution, a preventive; the other is an instrument of policy.

They are, however, related together. The system of price control, rationing and subsidies, together with the bulk purchases of staple foodstuffs and the regulated production of utility products, primarily directed as it is to ensuring a fair distribution of essential things under conditions of scarcity, is at the same time a defence against inflation. Wages, as we saw above (p. 56), are the fundamental measure of the wealth-value of money, and, so long as wages are kept within bounds, the battle against inflation is not lost. In the absence of any direct control of wages, the vital condition of resisting demands for increases is a limitation of prices and of the cost of living.

A control of capital outlay primarily directed to reserving adequate resources for operations to which policy allows priority, such as housing, and the making good of critical deficiencies, also helps to stave off inflation by keeping total capital outlay within limits. But as a defence it is incomplete, for there is always the possibility that the money withheld from capital outlay will be spent on consumption.

The reason for the crucial importance of wages is the reluctance of wage-earners to accept reductions. Their reluctance applies alike to money wages and to real wages. When the cost of living rises, real wages are diminished unless money wages are raised in proportion.

When the balance of prices and wages is disturbed by a monetary expansion, when, that is, the flow of money is enlarged, it is quite right that money wages should be raised in proportion; otherwise the distribu-

tion of the product between wage-earners and profit-makers would be arbitrarily altered. The adjustment of wages to prices merely maintains real wages. If thereafter the flow of money contracts again, and prices fall, real wages increase. But then the reluctance of wage-earners to accept a cut of money wages comes into play; costs are not diminished in proportion to prices, profits are reduced and even turned into losses, enterprise is discouraged, and depression and unemployment supervene.

The resistance to a reduction of money wages is not wholly unreasonable. It is never possible to say precisely what reduction is needed to fit the monetary situation. And no reduction will suffice to maintain activity and avoid unemployment, so long as there is an expectation of a further reduction, for, if costs are expected to fall, purchases and orders to producers will be postponed. Even if the overall reduction required in the wage-level could be estimated, the actual wage bargains are made in particular industries, and ultimately with individual employers. Each industry has its own special circumstances, which have to be reconsidered every time the wage question is reopened.

It is possible to include a cost-of-living clause in a wage bargain. An official index number measures the average change in the prices of a selection of the staple requisites of working-class life since a given date, and employers and employed agree that rates of wages shall vary automatically in proportion to the index. That does not prevent other circumstances which point to a change in wages being dealt with on their merits, but the starting-point of a fresh bargain is the wage adjusted to the index, not a fixed money wage.

The index of cost of living approximately reflects

changes in the value of money, and, in and after the First World War, some such arrangement was indispensable to avoid constant friction in revising rates of wages. When the big deflation of 1920–2 occurred, the level of wages in Great Britain was automatically reduced by some 36 per cent. The reduction did something to mitigate the severity of the depression, but it did not prevent the number of unemployed rising to two million. That was partly because the retail price-level, on which the index depends, moved (as it almost invariably does) much less than the wholesale price-level, partly because the end of the process could not be foreseen, and employers were always anticipating a further fall.

And even when a fall of wages is the automatic result of an agreement based on the cost of living, it is apt to cause resentment and discontent. The experience of 1920–2 made wage-earners very resistant to any proposal for wage reductions in the succeeding years. The restoration of the gold standard in 1925, accompanied as it was by a dose of dear money unprecedented at a time of heavy unemployment, required a substantial general cut in the wage-level to secure monetary equilibrium. The lamentable story of the subsidy to the coal mines and the General Strike of 1926 followed.

Public policy is deeply concerned with the level of real wages, or, in other words, the standard of living of the wage-earners, who are the great majority of the occupied population. But, if the flow of money be supposed *given*, there is a limit to the level of money wages. An excess over the limit encroaches on profits and causes unemployment. A reduction of wages being ruled out, the only remedy is an increase in the flow of money.

If wages are below the level appropriate to prices, a rise towards that level will not restrain enterprise or cause unemployment. But, once that level has been reached, a further rise will confer no benefit on the wage-earners; they must submit either to unemployment or to a rise of prices, which will make their apparent gain illusory.

In fact, the dependence on profit-making as the motive of enterprise necessitates a distribution of the community's output which secures a certain share to the profit-makers and thereby limits the share of the wage-earners. When the wealth to be shared is diminished by scarcity, it is useless to try to maintain the wage-earners' standard of living by raising money wages.

The profit-making system imposes an iron law of wages. It is not so rigid as the iron law of the "subsistence wage," which Marx inherited from Ricardo, because, as productivity increases, the limit is correspondingly raised, but with given productivity the limit is there.

But it is not to be inferred that public policy can do nothing to improve the standard of living. For it is possible to tap the profit-makers' incomes by taxation, and use the proceeds for the social services, such as education, health, housing and pensions for old age, disablement or other special needs. Taxation (so long as it is not raised to the point of confiscation) does not impair the profit-maker's motive; he still seeks to make as big an income as he can.

During the war this process of drawing on the proceeds of taxation to improve the standard of living of the wage-earners has been carried a stage further, in that there are direct subsidies to keep down the prices of food. The subsidies are received by all, rich as well

as poor, and taxation is imposed on all, poor as well as rich, but the purpose is to fend off claims for increases of money wages. That purpose could even be attained consistently with the burden of the taxes imposed being so far on the wage-earners themselves that on balance they received no gain.

23. *Foreign Exchange*

Every country is separately responsible for its own fiscal system. The standard of living it can support for the mass of its people depends on the country's resources. For a self-supporting area, capable of producing adequate staple requisites for its inhabitants the problem is one of economic efficiency and equitable distribution. But for one which cannot provide a sufficiency without imports from abroad the problem is more complicated. Imports have to be paid for.

I have described money as a forbidding yet fascinating subject. What then is left to say of foreign exchange? It is a part of the theory of money, the most esoteric and enigmatic part. Yet I do not think a straightforward exposition of the principles of foreign exchange is beyond the capacity of plain language.

We have seen how production and all forms of economic activity generate incomes equal in total to the value of output, and the incomes generate outlay. When a country engages in international trade, some of the incomes are derived from goods sold abroad, and some of the outlay is upon goods bought abroad. Settlement of accounts requires that the money unit of an exporting country be valued in terms of the money unit of the importing country, and the foreign exchange market is the organization which the world has set up to meet this need.

In the foreign exchange market those who have acquired money abroad by selling goods or services, or in any other way, offer this money in exchange for money in their own country. It is a competitive market, which so long as it works effectively, determines at a given moment of time a definite price of any one money unit in terms of any other. When the rate of exchange between London and New York is \$4 to £1, the price in London of the right to receive \$10,000 in New York is £2,500, and the price in New York of the right to receive £2,500 in London is \$10,000. What is dealt in is *bank credit*, the bills of exchange, drafts, cheques and transfers which are employed being instruments for assigning bank credit from one person to another. Bank credit is the equivalent of money, and is the means of payment in major transactions.

The foreign exchange market, by valuing every money unit in terms of every other, values incomes in any country in terms of what they can buy in the others. If a country's money unit is valued too high in terms of the rest, its people are enabled to buy too much abroad, more, that is, than the resources of the country can pay for. The same over-valuation of the unit makes prices abroad less profitable to the country's exporters, and the consequent falling off of exports makes the gap between what the country imports and what it can pay for all the wider.

The country incurs *external indebtedness*. With a gold standard external indebtedness can be discharged in gold. The essence of a gold standard is that bank credit can be converted into gold and gold into bank credit, and gold is free to move, so that when dealers in the foreign exchange market find themselves burdened with bank credit in any country for the discharge of external

indebtedness, and cannot set it off against indebtedness in the opposite direction, they can settle the balance by turning the bank credit into gold and sending the gold to the countries of the creditors, there to be converted into bank credit for them.

The gold standard question is inherently a foreign exchange question. Gold reserves are limited, and a country suffering an outflow of gold to discharge currently accruing external liabilities cannot stand a continuance of the loss indefinitely. The odium into which the gold standard has fallen is due to the assumption that the outflow of gold must be stopped by a contraction of the flow of money, that is to say, by deflationary measures, which, if effective, cause depression and unemployment.

Even when the gold standard is discarded, some means of settling balances of indebtedness between countries is needed. Otherwise every casual undischarged balance will disturb the markets. The dealers in exchange will fight shy of any currency of which they find themselves holding too much, and will try to unload at a sacrifice of price. In the absence of any clear guidance as to how long the adverse position will last, or what would be a stable rate in terms of other currencies, there is no clear limit to the variations in rates of exchange. Fortuitous unsettled balances of international indebtedness are constantly occurring, and, if the market were left to itself, the result might be a chaotic uncertainty. Dealers in exchange who make an expert study of the prospects may steady the market by holding up temporarily unsettled balances as a judicious speculation. But there is a danger that the occurrence of a balance of indebtedness against a country may be interpreted by speculators as the prelude

to further weakness, so that speculation works not as a corrective but as an aggravation of the adverse position. Discredit and monetary collapse may result. The presence of redundant money is especially a source of danger. Its spending power may be directed in mass abroad, upon commodities, securities and any other assets, and may overwhelm the foreign exchange market.

Nowadays countries which have abandoned the gold standard hold reserves of foreign exchange instead of gold. That is to say, a government or central bank will hold bank credit or readily realizable securities at one or more important foreign centres, upon which it can draw in case of need to supply the foreign exchange market with the means of settlement. The foreign centres chosen for the purpose are such that money available in them will be readily saleable in any third country.

The International Monetary Fund evolved at Bretton Woods in 1944 is a centralized foreign exchange reserve, comprising the currencies of all the participating countries and available to be drawn upon within limits by each. Based on the presumed continued use of gold as a medium of international settlements, it is a device for economizing reserve gold.

24. *Exchange Control*

A government or central bank so employing a reserve of foreign exchange determines the rates of exchange in the market. The rates at which it is prepared to buy or sell foreign currencies dominate the market so long as its reserve is not exhausted. And in the absence of a gold standard it can correct a drain on the reserve by raising

the rates at which it sells foreign money, and can thereby avoid the need for deflation.

But raising the rates at which it sells foreign money units means visibly depreciating its own money unit. If there is some tendency at work, threatening a further depreciation, there is still a danger of discredit, panic and collapse. In the years following the First World War most of Europe suffered from redundant money threatening an ungovernable inflation. A remedy was sought by many countries in *exchange control*: purchases of money abroad were prohibited except for purposes expressly permitted, and the permitted purposes could be so limited in scope and character that there would be no balance of indebtedness abroad to be met, and the cause of depreciation would thus be eliminated from the market. At that time exchange control proved ineffective in the face of panic-stricken flight from a discredited currency. It was impossible to prevent wholesale evasion and infringement of the law, when the acquisition of money abroad was not merely a means of realizing big speculative profits but was the easiest way of escape from impending ruin.

The nineteen-thirties witnessed a revival of exchange control. A deflationary movement in the gold standard countries (then including all the economically developed countries of the world) started in 1929, and attained a severity beyond all precedent. In the course of a few years the wealth-value of a given quantity of gold had more than doubled (that is to say, the prices of goods relatively to the price of gold had fallen on an average by more than half). The deflation required to maintain any money unit at its previously established gold value was insupportable.

As soon as it became clear that a country would be

unable to maintain its money unit at gold parity, distrust of its money and of all assets expressed in terms of the unit (such as fixed-interest-bearing securities) would set in. A speculative demand for foreign money and foreign securities would denude the reserves, and would soon threaten them with exhaustion. Suspension of the gold standard and avowed acceptance of a depreciation of the money unit proved in some cases an adequate defence. If the value of gold in terms of wealth doubled, and the value of the unit in terms of gold were halved, the wealth value of the unit would be preserved unchanged, and no deflation would be necessary. But some countries (among which Germany was the most conspicuous) were unwilling to depart from gold parity, and some depreciated their currencies too little or too late. Either way, their currencies became over-valued and consequently distrusted. As a last defence against a monetary collapse they had recourse to exchange control.

The root of the trouble having been deflation and not inflation, there was not the same fear of immediate ruin among those whose fortunes depended on the value of the money unit. There was not the same urgent motive for evading or infringing the exchange control as in the early nineteen-twenties. And experience had developed a more efficient administration of the control.

Exchange control in a number of countries was *effective* in the nineteen-thirties. The control consisted, as we have seen, in a prohibition of the acquisition of foreign money except for purposes expressly permitted. It could be used therefore for preventing payment both for current transactions (such as the importation of goods and the various services ancillary thereto) and for capital transactions (such as the purchase of foreign

securities or property or a speculative purchase of foreign money).

In itself an over-valuation of the money unit can be dealt with by a restriction of current transactions, and most of what that requires can be done by direct restrictions on the importation of goods, either high import duties, or prohibitions tempered by licensing. But import restrictions alone may well prove insufficient (particularly as, with an over-valued currency unit, the export trade becomes less profitable and falls off). It is the capital transactions which are the source of trouble when the currency comes to be distrusted, and, if they are to be restricted, exchange control is the only available instrument.

Over-valuation of the currency unit means a foreign exchange value which makes costs, or in other words wages, excessive in relation to international prices. The presence of redundant money may be regarded as a *potential* over-valuation, not to become actual unless the money is let loose and the spending of it leads to a rise of wages. But, even without the over-valuation becoming actual, the spending is likely to be in part directed abroad If the spending abroad threatens the country's reserves of foreign exchange or gold with exhaustion, exchange control may be the only immediate defence against panic and monetary collapse.

25. *British Exchange Control*

That was the position of many of the belligerents after 1918, and when war broke out in 1939, there was every prospect of its recurring and in an intensified form. Total war had become more total than ever, the financial strain more overwhelming. In Great Britain the infla-

tion of the years 1914–18 had been allowed to produce its effect on the price-level with little impediment, and by 1920 the flow of money had so expanded that the increased stock of money was little if at all redundant. In 1939 it was settled policy to institute controls which would prevent prices rising to such an extent. Inevitably there would be redundant money. The controls would have to include a restriction of imports and a restriction of capital outlay, but they would be incomplete unless the redundant money were prevented from seeking an outlet in the acquisition of capital abroad, whether money, securities or property. Money held idle at home in the form of bank credit would in effect be lent to the government, since the banks in war-time would hold Treasury bills or other Government securities against it. But money transferred abroad would be withdrawn from the Government's use. It was to prevent such transfers of capital abroad that exchange control was added to the other controls at the outbreak of war.

And not only was the transfer of capital prohibited, but the Government took power to requisition external assets already held or currently accruing. It was thereby supplied with the means of paying for supplies of all kinds obtained from overseas, both the munitions and other equipment for the forces and the essential imports of food, materials and other goods, whether bought by the Government itself or by traders. The free foreign exchange market of peace-time was superseded, and transactions were monopolized by the Treasury, which employed the great banks as its agents, both for dealing in exchange and for administering the exchange control.

Without the power of requisition the Government could only have used these external resources through

the working of markets. Holders might have sold them in order to lend the proceeds to the Government, and could have been urged to do so on patriotic grounds. But some would have clung to their holdings or would only have parted with them at a high price. Requisition dealt with the matter comprehensively, and without any disturbance of market prices. In circumstances in which a belligerent government could not borrow abroad on any considerable scale, these external resources were a vital contribution to the war effort. But their use is yet another cause of impoverishment, a dissipation of accumulated wealth, along with the depletion of stocks of goods in traders' and individuals' hands, and the neglect of property and plant.

The British exchange control has also worked in a less obvious way to procure the country external resources. The control gives the British Government power to regulate the disposal of any money accruing in the United Kingdom to people resident outside the country, and, in virtue of this power, it has been able to make arrangements by which a number of countries accept in payment for exports to the United Kingdom accumulating balances in pounds sterling, the use of which is limited to current payments for their imports from the United Kingdom and other permitted purposes. The countries concerned fall into two groups. There are those composing what is called the Sterling Area, comprising the British Empire (except Canada and Newfoundland) and a few outside countries, such as Egypt and Iraq. These are countries which base their monetary systems on reserves of pounds sterling held in London, and which have so fitted their own exchange controls into that of the United Kingdom that the whole Sterling Area can be treated as a unit for the

purposes of control. There is no exchange control (except for very limited purposes) between one country of the Sterling Area and another. A Sterling Area country which receives funds in London in payment for goods supplied or services rendered to the United Kingdom is adding thereby to the reserves which form the basis of its monetary system. It can use its sterling funds for purchases from other members of the Sterling Area, and the money acquired by members of the Sterling Area from outside countries in the shape of foreign exchange is centralized in the hands of the United Kingdom control, and made available for the imports and permitted external payments of the Sterling Area as a whole.

Arrangements were also made with certain neutral countries for payment for their exports to the Sterling Area to be accepted in the form of sterling which can only be used for payments to the Sterling Area.

26. *Externally Owned Sterling Funds*

In the first two years of the war heavy drafts were made upon the external resources of the country, pre-existing reserves, requisitioned foreign exchange and requisitioned securities being used to pay for supplies, especially for those obtained from North America. The liberal help given by the United States under the Lease-Lend Act of 1941 and by Canada as mutual aid came none too soon, when the country's means of raising dollars in this way were on the point of exhaustion. But the indebtedness in the form of sterling balances held by other countries was rapidly growing, and soon began to reach formidable dimensions. By the end of the six years of war it exceeded £3,000,000,000.

Here was impoverishment on a portentous scale! The country had devoted itself to the conflict regardless of cost. It had received very welcome, indeed indispensable, help from the United States and Canada. But elsewhere supplies could only be procured against payment or the promise of payment. Neutrals could not be expected to subsidize a belligerent.

The most striking instances of this form of accumulating indebtedness are countries which, whether neutral, belligerent or something between, have been the scene of big military operations or of occupation by large forces. The disbursements of the occupying forces have to be made in the local currency. How is that currency to be procured? The occupying forces raise it in exchange for their own home currency. But their disbursements are not part of the budget expenditure of the occupied country, and its government makes no provision to meet them. Under peace-time conditions traders of the occupied country would use the bank credit they receive in the occupying country to pay for their needs abroad, and would import the equivalent in goods or investments. But under such war conditions as the world has recently experienced there is an intense dearth of importable goods, and little inclination to acquire foreign investments. Redundant money is the result, probably in greater relative volume than in the principal belligerents themselves, for these latter at any rate make efforts to raise as much money as possible from revenue and sound borrowing, and to keep inflationary expedients within limits.

The redundant money in these countries consists of paper money, against which they hold equivalent sterling balances (either bank credit or short-dated Government securities) in London. What would be the use of

extinguishing the redundant money held in Great Britain, if this vast fund of latent spending power were left unrestrained? The countries within the Sterling Area are a special source of difficulty. Their monetary systems are based on the convertibility of their money into sterling. Any holder of rupees in India, or Ceylon, or of Egyptian pounds in Egypt or of Palestinian pounds in Palestine, can procure money in England at the prescribed rate of exchange. Money in England can be used to buy imports from England, and all the countries concerned will be suffering from acute shortages. But Great Britain will also be suffering from shortages, and, even when her exporting power has been fully restored and all potentialities developed, the exports that can be spared for several years are likely to be small in comparison with the spending power released in these Sterling Area countries,

The theory of the Sterling Area exchange controls is that Great Britain supplies the members with the outside currencies they need. Payment for imports is a permitted purpose, the limitation of imports being effected not through the means of payment, but directly by prohibitions subject to licensing. So long as the war continued, imports were perforce limited by the shortage of supplies and the shortage of shipping, so that the import licensing system was subjected to no great strain. But when these shortages are made good, the position in India, for example, will be that people will have plenty of rupees to spend on things which they urgently need, that the export industries of the United Kingdom cannot nearly cope with the demand, but that there will have to be severe limitations on the amount of rupees that may be spent on imports from elsewhere.

That, it may be said, is only the disorder from which

all participants in the war are suffering. But in the case of any member of the Sterling Area there is a special complication in that the currency is not merely convertible into pounds sterling but is backed by sterling funds in London. Even if a part of the reserve of sterling funds were tied up in some way (for example, transformed into a non-marketable security, such as a single big annuity for a term of years) the rest would remain to be drawn on and to maintain convertibility. If on the other hand the *whole* of the London funds were blocked, there would no longer be the means of supporting the currency at parity with the pound or at any desired rate of exchange.

The problem is thus the existence of redundant money in one country backed by funds in another, so that the release of spending power in the former will demand far more of the products of the latter than can be made available. If inflation has reached precisely the same stage in both countries, and money precisely the same degree of redundancy, one solution is to let the spending power loose in both, and allow the price-level to rise till the money ceases to be redundant. The perils of that course have already been indicated (p. 43 above). The alternative is the extinction of the redundant money by a heroic fiscal operation such as a forced loan. That would be feasible in Great Britain, but could it be applied in one of these other countries? In oriental communities bank credit is relatively unimportant, the acceptance of paper money is by no means securely established, and much of the monetary circulation is in token silver coin. And where there is no adequate investment market or stock exchange, a Government security is for many people a very poor substitute for cash.

But even if some such method of extinguishing redundant money were practicable, its application to a country where inflation had already produced a rise of wages and prices might be disastrous. A measure of deflation is salutary and endurable when it does no more than stop a potential inflation, and leave the actual wage-level and price-level as they are. If the wage-level and price-level have to be substantially reduced, the distresses which have made deflation odious inevitably result. In a peasant community money rates of wages may be relatively unimportant, but *debts* are not. Deflation so applied as to reduce prices substantially below the levels that have prevailed for several years will upset all the calculations of debtors, and cause a woeful crop of bankruptcies.

Some of the oriental countries which have had inflation forced on them by the expenditure of occupying forces have been quite unable to keep the effects in check, and a rise of prices has occurred in far greater proportion than in England. There has in effect been a heavy depreciation of the wealth-value of their money relative to that of the pound sterling. If, as must, I think, be presumed, the depreciation of wealth-value is irreversible, what is to be done? The rates of exchange prevailing for the pound sterling in world trade will be quite unsuitable for them. With their standards of prices and costs, these rates will make their export trade impossible. Can they for a time dispense with any export trade, and devote their own productive power, as well as the spending power conferred on them by their sterling funds, to remedying the shortages of goods of all kinds from which they are suffering? No country can afford to see its export trade extinguished. And the depletion of the sterling funds through payment for the excess of imports

would be accompanied by an extinction of the equivalent currency against which the sterling funds provided cover. That is to say, there would be a progressive deflation, with all its undesirable consequences.

27. *The Pound Sterling*

There is a discrepancy between the rates of exchange on London fixed for some of these members of the Sterling Area, and the wealth-value of their currency units in relation to the pound sterling, as determined by price-levels and wage-levels. Such discrepancies are not confined to the Sterling Area. Inflation, potential or actual, is present everywhere, but in widely different degrees, and different countries differ also in the extent to which they have tried to hold in check the inroads of inflation on the wealth-value of their currency units, or have succeeded in doing so.

All rates of exchange must be regarded as in the melting-pot, and they can only be remoulded after a period of trial and error.

The rates within the Sterling Area cannot be regarded as sacrosanct. If they were, the alternative to a painful reversal of inflation, in those where inflation has got out of hand, would be a resort to inflation in Great Britain. To re-establish equilibrium, that might mean reducing the wealth-value of the pound sterling by half. The wage-level in Great Britain is already fully 50 per cent higher than in 1939. If it were further doubled, and if the process could be stopped, and the wage-level and price-level held at about three times what they were in 1939, the country would at any rate be saved from the disaster of a complete collapse of money.

But a reduction of the wealth-value of the money unit

by half (and thus to one-third of what it recently was) is not a proceeding to be lightly accepted. It is hardly necessary to dwell on the extreme precariousness of the assumption that it could be stopped at that point. For even so the dislocation of economic relations would be catastrophic. Among all its disastrous consequences it will be enough to mention two: the deprivation of all those who have placed their savings in Government securities during the war of half the value of their holdings, and the reduction by half of the value of the externally owned sterling funds themselves.

When a country has become involved in inflation, and has to settle the future value of its currency unit, sheer weight of indebtedness may *compel* a heavy devaluation. But to reduce its indebtedness by an arbitrary devaluation would be an act of quite a different character. A devaluation of the pound sterling merely in order to adjust it to the weaker currencies of the Sterling Area could hardly be defended.

The pound sterling has retained the trust of mankind through many sore trials. It has by no means been exempt from loss of wealth-value. If the wage-level be taken as the fundamental test of the wealth-value of money, the pound lost half its wealth-value even in the golden age from 1844 to 1914. By 1924, after wild fluctuations, it had suffered a net loss since 1914 of some 40 per cent. People have, I think, been quite prepared to see some deterioration under the pressure of six years of war, and if the wage-level can be held at its present position (about 50 per cent above that of 1939) no one will protest that debts have been unduly lightened.

In order so to hold it, heroic measures will be called for, and even heroic measures may fail. Possibly a much heavier depreciation may be forced on the country, and

to that extent the burden of the externally held sterling funds will be lightened. But yet every effort ought to be made to preserve the wealth-value of sterling.

That is not to say that the countries holding sterling funds might not reasonably agree to a composition. Section 10 of the Financial Agreement of the 6th December 1945 with the United States (Cmd. 6708), looks forward to agreements being made with countries in the Sterling Area for "adjusting" a portion of these sterling funds, and for making a part of the residue at once "convertible into any currency for current transactions" and the rest similarly available by instalments over a period of years starting at the end of 1951. If an agreement of this character were reached with any country, so much of the sterling as continued to form part of its monetary reserves would naturally have to have from the outset whatever convertibility in terms of foreign currencies was to be conferred on the country's own currency. Any sterling accumulated outside the monetary reserves or released from them (so far as not "adjusted") might be made available by instalments.

The situation is paradoxical. These financially weak countries, in virtue of their very weakness, have become creditors of the United Kingdom on a scale so vast that even the accumulated wealth of the United Kingdom can only cope with the indebtedness, given time, by a gigantic effort. The financial weakness has increased the burden in a twofold manner: it has stood in the way of the weak countries raising any large sum of money by way of a contribution to the war effort; and the gap in the financial provision has been filled by the issue of currency to be purchased and spent by the occupying forces, so that the resulting inflation has raised prices and swollen their expenditure in proportion. If the

pound sterling preserves its wealth-value, and the weak currencies of the Sterling Area are devalued in terms of it, a smaller sterling reserve will suffice to support a given amount of these currencies. A portion of the sterling funds will cease to be tied up in the currency reserves, and can be made the subject of an arrangement. So much as is needed as a reserve will remain tied up, and not spent; it can only be released either by a reduction in the monetary circulation or by the provision of other funds to replace it.

Redundant money is a problem which will confront every country in the world. Some may be able to solve it by extinction of the excess. Some will suffer a substantial, possibly a calamitous, depreciation. But even the elimination of redundant money will not necessarily bring exchange controls to an end. Exchange control is an expedient for supporting a desired rate of exchange when no adequate reserves of foreign exchange are available. So long as rates of exchange are being settled by a process of trial and error, the actual rates will inevitably be such as to overvalue some money units in terms of others. Over-valuation of a unit attracts an excess of imports, gives rise to a balance of external indebtedness, and provokes distrust. But time is necessary to show whether there is anything more than a passing disequilibrium, and it may be essential meanwhile to prevent external indebtedness accruing. A restriction of imports of goods, however severe, may not suffice, if "invisible" imports, that is to say, purchases of foreign securities, property, money and other external assets, are unrestricted.

28. *Critical Deficiencies and Shortages in relation to International Trade*

The difficulty of arriving at suitable rates of exchange will be greatly intensified by the widespread economic distress. Every country must for a time be suffering from shortage of food and other staple requisites, from critical deficiencies in industry, from depletion of stocks of goods, from arrears of maintenance and renewals of property and plant, or from some or all of these troubles. Each will feel an intense need of supplementing its productive resources from those of the others. That to some extent the most distressed countries must receive help from those best able to spare it is generally recognized. What was said above (pp. 17–27) as to the twofold need of providing food and staple requisites and remedying critical deficiencies applies to the world as a whole, as well as to each country by itself.

In a single country the control of distribution, the control of supplies and the control of monetary policy are all subject to a single authority. The case of the world of independent States is more complicated. Their aim should be that already indicated above (pp. 20–23), to set *all* available productive resources to work as quickly as possible. The essential priorities accorded to the staple requisites need not and should not interfere with the resumption of other forms of activity. Along with these priorities, there should be a concentration on the critical deficiencies. In dealing with critical deficiencies, the same priorities must of course be observed, that is to say, those which interfere with the production and distribution of staple requisites will have to be dealt with first. But in very many cases that need not interfere with the immediate remedy of critical deficien-

cies which stand in the way of full activity in other directions.

The division of the world into independent States puts a difficulty in the way of this policy in that, whenever one country produces for consumption in another, the producers require payment. So long as they are producing for their own country, payment looks after itself; war conditions have left people in general with plenty of money in hand for their arrears of expenditure, and those unfortunates who are in need have in any case to be supported. But as soon as they produce for another country the problem of payment becomes one of international indebtedness, and of the foreign exchange market which sets off one country's money against another's.

If production under the conditions of post-war dislocation had to wait for full assurance of payment, who could put a limit to the delay? If the need is for every agency capable of producing to produce, production there must be without any such assurance. The producers must receive payment in the money of their own country, for without it they cannot pay the costs of production.

The immediate tendency will be for each country in the first instance to use its productive resources to supply its own needs, and to leave for export only those products which cannot be so disposed of. Most countries are regular exporters of some products of which they are equipped to produce much more than they can consume. That applies especially to those producing foodstuffs and materials: Australian wool, wheat and meat, Brazilian coffee, Canadian wheat, Argentine wheat and meat, Egyptian cotton, Indian jute, Japanese silk. It applies to some extent to manufactures, but exported

manufactures are much more miscellaneous, and, under conditions of general scarcity, more capable of being diverted to meet a home demand.

Countries with surpluses only disposable by export will be anxious to secure markets for them, and may well be ready to give credit to countries which are for the time being too exhausted to supply anything in return. That will not of itself give all the necessary relief, but provision has been made for relief through the United Nations Relief and Rehabilitation Administration, and is to be made for international lending operations on a large scale through the proposed International Bank for Reconstruction and Development.

It may be taken for granted that in the end much of the relief given will not be paid for; it will become a free gift, but presumably at the expense of Governments, not of producers or merchants. That will be because some of the recipient nations are too impoverished to repay.

29. *External Indebtedness*

There are more kinds than one of impoverishment. War as we have seen inflicts impoverishment in a depletion of stocks of goods and a neglect of property and plant as well as in actual destruction of wealth. The infliction is a temporary one, though the process of recuperation may be long.

There may be a permanent state of poverty due to an insufficiency of natural resources in proportion to the population, or to their want of aptitudes for remunerative economic activity.

But there is yet another form of impoverishment, that due to *indebtedness*. An internal national debt is a limited embarrassment; it may strain the fiscal mechan-

ism of a country, but what the taxpayers lose the bondholders gain. There may be an over-development of the rentier class, but that can probably be corrected by a suitable system of taxation. It is external indebtedness that impoverishes.

In engaging in international trade a country contributes such goods and services as it is favourably situated to produce to the totality of goods from which it, along with all others, derives imports. It is credited with the value in international markets of its exports, visible and invisible, and the amount of the credit determines the amount of the imports it may take. Under conditions of free marketing, rates of exchange settle down at a level which allows a balance to be preserved between the credit on account of exports and the debit on account of imports. In the absence of free marketing, the aim of the authorities regulating the exchanges is still to achieve and preserve this balance.

From time immemorial the world has been familiar with the case of the freehold cultivator burdened with excessive mortgage indebtedness, who has to sell as much of his produce for cash as he can to meet his obligations, and, after providing his own subsistence, has little left for the upkeep of his fixtures and plant. But he at any rate sells in a market where the money he receives is the same as the money he owes, and where his own sales are not big enough to disturb the market price.

A debtor nation's task is not so simple. Room has to be made between its imports and its exports for its external obligations, including, if it is to look forward to freeing itself from debt, instalments of principal as well as interest. That means a *different level of rates of exchange.*

If the country's money unit depreciates, that is to say, its value in terms of foreign units is reduced, the effect is to make prices in international markets so much higher in terms of its own unit. Exports become more profitable; imports become dearer. Exports are stimulated; the demand for imports is diminished.

But that is only accomplished so long as the wage-level remains unchanged. Exports are more remunerative because prices abroad are higher *relatively* to costs at home; imports are dearer because prices abroad are higher *relatively* to incomes at home. Let wages rise, and the differential effect is diminished; let wages rise in full proportion to rates of exchange, and the differential effect is lost altogether. In fact, the essential condition of making exports more profitable is that *real* costs, and therefore *real wages* (the value of wages relative to wealth), fall.

And the same is true, though not quite so directly, of the discouragement of imports. To that end the prices of imports must rise *relatively to incomes*, and the level of wages sets the standard for the level of incomes. With any given level of wages, the price-level and the resulting profit margins must be such as to give the necessary stimulus to enterprise; failing that there will be unemployment.

When the money unit depreciates and wages are unchanged, profit margins will actually *increase*, not only in the export industries but in those competing with imports. The attraction of productive resources into the latter as well as into the former helps to create an export surplus to pay for the indebtedness.

On the other hand, the increase in production for export is likely to influence prices in world markets. The contribution of one country's exports to the world

supply of a commodity is not a negligible factor, and any substantial increase in the quantity to be marketed will probably necessitate some concession in price, to be set off against the increase in profit margins. And there will be newcomers into the export industries who fail to realize more than normal profits.

On the whole, however, there is likely to be an increase in profit margins; profit-makers will obtain a larger share of the national income than before. That is the condition of achieving an export surplus under international competitive conditions. To increase the country's competitive power, its costs have to be reduced in terms of wealth. That is to say, "real" wages must be lower.

The country sells more and buys less. Does that not mean that in discharging its indebtedness it is causing a deficiency of demand and consequent depression in world markets? Not at all. The payment of its indebtedness simply *transplants* equivalent spending power into the creditor countries; they enjoy an accession of spending power sufficient to balance the additional supply of goods.

If the indebtedness is a Government obligation, the Government has to budget for it. The spending power is withdrawn from the taxpayers and used to buy the foreign exchange produced by the excess of exports, and this foreign exchange provides the means of paying the foreign creditors.

30. *The Position of Great Britain*

By one fateful plunge Great Britain, from the greatest of creditors, has become the greatest of debtors. The war effort outlasts the war, and here is an effort which *has*

still to be made. The extent of the loss of external investments and of the new external indebtedness incurred is shown in the statistical material presented during the Washington negotiations (Cmd. 6707). External liabilities have risen from £476 millions in August 1939 to £3,355 millions in June 1945 (p. 10). External assets and gold have been parted with to the value of £1,270 millions. The addition of that sum and some miscellaneous items to the increase of £2,879 millions makes a recorded net loss of £4,198 millions, which is described as "probably an underestimate" (p. 12).

The country's income from dividends and interest from abroad is nevertheless still estimated to exceed its payments, leaving a net receipt of £97 millions (p. 10). But that allows nothing for the service of the new American loan (£35 millions a year from the end of 1951) nor for the release of instalments of the externally owned sterling funds.

Even so, it may be said, it may yet turn out that the *current* burden of the country's indebtedness is *nil.* If so, where is the difficulty?

The answer is that the economic life of the country has grown up in conditions of dependence upon a vast mass of imports, a considerable part of which has been paid for by the yield of external investments. The same reasoning which shows that a debtor country has to be content with a relatively low standard of living to create the necessary export surplus, shows that a creditor country can enjoy a relatively *high* standard of living by reason of its import surplus. A wage-level high relatively to world prices means high costs both for exporters and for the producers who compete with imports. But that is no disadvantage, because the economic system has

adapted itself gradually to the growing yield of the external investments. So long as there is no discontinuity in the process, the volume of exports does not have to be reduced; it merely grows more slowly than it would have otherwise.

The adjustment for debtor and creditor alike tends to be made rather in imports than in exports. Exports are usually more specialized than imports, and the proportion of a country's productive resources engaged in them does not vary easily in response to greater or less costs.

The income derived by a creditor country from its external investments constitutes additional spending power. The additional spending power is applied in part to imported goods (including further external investments, the acquisition of which is an "invisible import"). If it were *wholly* so applied, no further adjustment would be required. If the additional spending on imports is something less than the external income, an expansion of the flow of money, the number of money units composing the national income, is required in order to attract more imports. The rise in the wage-level is incidental to this expansion of the national income.

The expansion of the national income is relative to world prices; it need not be an increase in terms of the country's own money unit. A rise in the foreign exchange value of the unit itself, without a proportional change or without any change in the national income in terms of the unit, would have the same effect. The latter alternative would leave money wages unchanged, but would raise the standard of living by making all goods in world markets cheaper in terms of the money unit. Great Britain has for a century been enjoying a high

standard of living in this way. Her exporting power, depending on special aptitudes and resources, has remained high; her imports have been swollen to an enormous total.

Her position is not to be fully understood merely as that of a great creditor nation. For her favourable economic position has been associated with a great growth of numbers; there has resulted a concentration of population in an area so small that a huge volume of imports has become a *necessity*. To provide food and materials for so many, a far larger land surface is needed than that of the British Islands themselves, and a correspondingly large part of the necessary supplies has to be imported from overseas. People cannot easily be induced to dispense with these necessary supplies by such increase of prices as any depreciation of the pound sterling that could be contemplated would secure. The supplies are largely of the kinds that enter into the cost of living of the masses, foodstuffs and the materials of staple requisites, such as textile materials or timber.

31. *Stimulation of Exports*

Moreover, there are limits to the extent to which a depreciation of the currency (or a reduction of costs relative to world prices effected in any other way) can promote an expansion of exports. When costs in the export industries are very low, and profits correspondingly high, there will be an exaggerated influx of productive resources into those industries, and the pressure of increased sales may so lower prices in the country's export markets that the total proceeds of the exports become actually less than before, though the excess of prices over costs yet remains attractive.

The most suitable rate of exchange for the United Kingdom will be that which, at the existing wage-level, gives the greatest stimulus to the export industries short of overstraining their export markets. The rate in terms of American dollars is already substantially lower than it was before the outbreak of war. British wages have increased by 57 per cent, but American wages have increased by nearly as much (on the top of an increase of 20 per cent between 1929 and 1939). It may well be that, provided no great further increase occurs in wages, the existing rate of $4.03 (possibly even a higher rate) will be found to be about right.

Much has been said about the need to increase the country's pre-war volume of exports by half or even by three-quarters. Undoubtedly, whatever can be done by wisdom and energy towards increasing exporting power ought to be done. But it is not certain that the highest attainable exporting power, combined with the most judiciously determined rates of exchange, will by themselves suffice to meet the country's indebtedness and pay for its essential imports.

If they fail to do so, we have one more instance of a need transcending the self-adapting power of free markets, such a need as has been dealt with by Government initiative in war-time. How then might Government initiative be applied here?

The need for every possible stimulus to exports is well recognized. We assume rates of exchange to be such as to favour a maximum total value of exports; production for export therefore is profitable, and it is to the interest of traders to push exports. Nevertheless, there is scope for Government action. A Governmental authority can take a more comprehensive view of the field, and can inform traders of opportunities which they might other-

wise not be aware of. It can promote co-operation among exporters and discourage undesirable forms of competition, those methods of obstruction, secretiveness and financial manipulation by which traders try to put their rivals at a disadvantage. And by information and advice it can foster efficiency in methods of production, marketing and business organization.

All this is not a matter of controversy. The greater the success in enlarging the natural flow of exports, the less will be the strain on the country's balance of payments. But no one will expect unlimited results. The Government can assist and enlighten private enterprise, but does not create it, and cannot direct it to opportunities which do not exist.

Moreover, the motive of private enterprise is profit, and the export trade will be in competition with production for the home market. Both export market and home market will be exceptionally profitable under conditions of post-war scarcity. There will also be redundant money to swell demand in both. What will be the relative effects of scarcity and redundant money upon price-levels at home and abroad it would be no use trying to predict. But at any rate there is an obvious danger of the expansion of the export trade being defeated by the intensity of demand at home. If that is to be counteracted by Government action, something more than advice and suasion will be needed.

It is hardly practicable to maintain under peace conditions the regimentation of labour which war has justified. The direction of the country's industry cannot be determined by a mandatory allocation of labour. So long as a scarcity of materials continues, and supplies of them are controlled, the activity of those industries which use the scarce materials can be regulated by

miting their share. Export industries, like those pro-ucing staple requisites such as food, fuel and shelter for ıe home market, can be given priority. But a world :arcity of materials will not go on for ever. Of many ıaterials the release of shipping will quickly suffice to ring adequate supplies.

32. *Restriction of Imports*

ıre imported materials to be controlled? Those nported for use in the manufacture of goods for export ay for themselves, and can be taken for granted. But ıaterials to be used in manufactures for home con-ımption are part of the problem.

Many countries have been driven to restrict their nports for the sake of their solvency. Formerly estriction would take the form of import duties high nough to be deterrent or even prohibitive. More ecently direct quantitative restrictions have plagued the fe of international traders.

A distinction has to be made between the restriction f imports which *compete* with home industries and the estriction of imports which *supply* home industries with ıaterials. It is the latter that we are now considering, s a method of limiting production for home consump-ıon, and so releasing labour and productive resources or the export industries.

The need for restricting imports of materials might ersist, even though there were no world scarcity of ıem. To restrict the production of a commodity of which there is a pressing demand, betokening a real need, y limiting the supply of materials of which there is no hortage, would be a paradoxical course. But if the ountry really could not afford to pay for the imported

materials, the restriction might be justifiable. The same position might arise with food. Imports of foodstuffs might have to be restricted, and consumption rationed, in spite of the world enjoying plenty.

Here is revealed all too clearly the war effort that outlasts the war. The country has consumed its substance, and has to face a lowered standard of living. Rationing, where it is possible, makes more tolerable the privation which scarcity would otherwise inflict, but it does not remove the scarcity. And it will be chiefly in the unnumbered miscellany of products for which rationing is either impracticable or inappropriate that the most severe restriction of imports must be applied. Some of them can quite well be produced at home without any very considerable disadvantage of price or quality, and, so long as this diversion of productive power does not encroach on the labour, materials or plant required either for staple requisites or for export products, it need not be interfered with. But only so long.

It must not be forgotten that foreign travel is an "invisible import," having to be paid for, like imported goods, through the foreign exchange market. Is it to be classed as a superfluity to be suppressed or restricted? Surely not. Its value as a contribution to the good life is such that heavy sacrifices would be justifiable to preserve it. Onerous taxation at home and adverse rates of exchange abroad are likely in any case to reduce foreign travel below what is desirable, and it is to be hoped that any further restriction will be dispensed with.

33. *Social Services and the Standard of Living*

The fundamental requirement is a limitation of consumption. That indeed is the inevitable inference from

impoverishment. On the one hand, the limitation of consumption is necessary both to set free resources to meet external indebtedness, and to pay for necessary imports, and also to dispense with any excess of imports over what can be paid for. On the other, it is likewise necessary to set free resources for reconstituting stocks of commodities, and for making good arrears of upkeep and capital outlay. Limitation of consumption is just another name for a reduced standard of living. That does not necessarily mean a standard equally reduced for all, rich and poor alike. Primarily, indeed, the standard of living of the masses depends on the wage-level, and the wage-level is governed by the flow of money. But in the past hundred years there has grown up a system of social services by which the greater incomes are taxed towards making good the deficiencies of the lesser incomes.

The subsidies in aid of the cost of living are an extension of this system. Their purpose is to disarm demands for higher money wages by making a given money wage represent a greater real wage than the economic price-level would otherwise allow. If the country, with depleted capital resources at home and abroad, cannot afford the standard of living to which people have been accustomed, there will be pressure to fill the deficiency by means of more liberal social services.

This tendency is already in full swing. It is settled policy to supply certain things, education, housing, health services and provision in various forms against loss of earning power, either at a cost reduced by subsidy or altogether free, and that policy is being extended. *Consumption* is thus to be subsidized on an increased scale at the expense of the taxpayers. The wage-earners themselves bear a part of the burden, both in the con-

tributions deducted from wages for insurance and in the taxes they pay. But to that extent the wage-earners' standard of living, taken as a whole, is not raised; there is merely a transfer of resources from those among them whose needs are less to those whose needs are greater. A policy of raising the standard of living of the masses requires the higher incomes to be drawn upon.

But to that process there is a limit. Taxation at the war-time level in Great Britain has been cutting deep into wage-earners' incomes.

Mr. Kaldor has estimated that in a post-war year under conditions of full employment the tax system actually in operation in 1938 would produce a revenue very nearly sufficient to meet all the additional expenditure arising from the extension of the social services in prospect as well as defence and the National Debt charges.[1] That is on the assumption that the subsidies in aid of the cost of living *stop*. It also excludes any sinking fund for the redemption of debt out of revenue. Whether, even with these exclusions, his estimate of expenditure is sufficient is doubtful. New possibilities of improving and extending the services rendered by the State are constantly being thought of. There are undoubtedly many gaps in the educational system and the social services which existing forecasts of future expenditure do not fully cover.

Mr. Kaldor estimates future defence expenditure at £480 millions. If the world achieves such safeguards of peace as will really command confidence, a much smaller outlay may be found to be permissible, but that cannot as yet be taken for granted. Defence expenditure may even be much greater.

[1] Sir William Beveridge's *Full Employment in a Free Society*, pp. 382–3.

If £480 millions be accepted as a reasonable estimate, it must be remembered that the money spent on the forces on a peace footing is much less than the contribution which the same numbers would be making to the wealth of the community in industry. That is in marked contrast to the immense outlay per head in war, when costly equipment is being recklessly and rapidly used up and exposed to immeasurable waste and destruction. Consequently, the £480 millions would represent a substantial curtailment of the national product and taxable capacity, in *addition* to the direct budget expense.

34. *Debt Redemption and Capital Needs*

All this is conjecture upon conjecture. The two questions of future subsidies and future sinking funds are more substantial.

The annual provision for the reduction of the internal debt is not only an indispensable support of national solvency and credit-worthiness, but at the same time a powerful instrument for influencing the capital market. There are arrears both of capital outlay and of consumption outlay. If the redundant money is successfully extinguished or kept in check, the provision for overtaking the arrears of capital outlay must be made *out of income*. That is to say, genuine savings, an excess of incomes over consumption outlay, must be made available. But to the individual consumption outlay will seem more urgent than saving; it includes not merely current consumption, but the replenishment of essential stocks of personal and household equipment, replacement of things worn out, overdue upkeep of property. Much of this may actually claim to be reckoned as saving, for it is the acquisition or preservation of durable

articles of use or enjoyment, "consumers' capital," forming part of the community's accumulation of wealth. But the country cannot afford to allow priority to consumers' capital over industrial capital. A shortage of consumers' capital may mean privation, and a certain minimum is of course reckoned among staple requisites, such as houses, furniture and utensils, and is accorded an undisputed priority. But for staple requisites themselves the appropriate instruments of production have to be provided and maintained.

How can adequate resources be assured in the form of savings for the essential capital outlay of industry? If the free action of the individual recipients of income cannot be relied on, some measure of interference by authority is needed. The Government might itself raise loans in the investment market, and make the proceeds available to industry, or itself undertake the necessary capital outlay. But, in order to achieve the desired result, the loans must be subscribed by investors *out of income*. Should the amount so subscribed be insufficient, the balance can only be supplied by inflationary means. If that is to be avoided, those unwilling to save must be taxed. Taxation is appropriate, not a forced loan, because the amount to be raised is no more than a fraction of current incomes, and the aim is to procure payment out of income. A forced loan or a capital levy would be paid out of capital.

By budgeting for a surplus, and applying the money either to the redemption of debt or directly to capital outlay, the Government is imposing an act of saving on the community. It is sometimes assumed that raising money for the repayment of national indebtedness is a deflationary measure. But that is not so. It is only deflationary if the repayment is so directed as to extin-

guish money or bank credit, or if the recipients of the redemption money hold it idle. When heavy arrears of capital outlay are pressing on the resources of the investment market, flotations and sales of securities will quickly absorb whatever additional resources are placed in the market by Government action. In fact for a long time to come industrialists will be selling Government securities previously accumulated in reserves, to raise funds for arrears of capital outlay, and the Government's sinking fund redemptions would provide a market for them.

Exponents of the doctrine, now fashionable in some quarters, that money does not matter, and that the country can live merrily in the future as in the past on a daily deficit, may regard the idea of redeeming debt out of a surplus as an antediluvian survival. But living on a deficit is precisely what has impoverished us, and the longer we continue to do it, the greater will be the efforts and privations to be endured in a future which cannot be long postponed.

It is hard to see any alternative to the raising of a surplus revenue as a means of ensuring an adequate supply of savings. And even that expedient is neither infallible nor unlimited. If people are heavily taxed, they are apt to reduce their savings, and, beyond a certain limit, to draw on their capital. The amount effectively added to the country's accumulation by the use of surplus revenue to redeem debt or to meet capital outlay, is substantially less than the amount so applied. Overburdened taxpayers cannot live on their capital for ever. Eventually they must retrench. But some encroachment of taxation on current savings is a permanent effect.

Savings come largely from the incomes derived from

profit-making. The recipient of an income that is large yet fluctuating, and possibly precarious, cannot prudently devote the whole to his current needs. And it is especially on these incomes that heavy direct taxation falls. The big fortunes which yield fixed incomes in rent and interest do not carry the same obligation to save, but they suffer a direct loss of capital through death duties.

Much of the saving out of profits is in the form of undistributed profits of companies and firms reinvested in their businesses. But much also comes out of dividends and distributed profits, invested by the recipients through the investment market. Up to a certain point an income tax will have little adverse influence on saving. The taxpayer whose saving is directed to a plan for the future may make a special effort to maintain the saving undiminished, when the future income is likely to be as heavily taxed as the present. But the tax may be so heavy that undiminished saving will mean an excessive sacrifice of present consumption to the future, or may even eat up the whole untaxed residue of his income.

Something might be done by exempting undistributed profits from taxation, so that one big part of accumulation remains unaffected. But that means a heavier rate of taxation on the distributed incomes.

There is thus a limit to the saving that can be extracted in the form of surplus revenue from the profit-makers. On the other hand the taxation of incomes from which normally no more than a small proportion is devoted to saving does effectively cause that diminution of spending on consumption in which saving essentially consists. A surplus revenue derived from the taxation of wages and moderate salaries will be nearly all an additional accumulation. Whereas the recipient of a fluctuating

income from profits maintains a fairly steady rate of consumption and accumulates the fluctuating balance, in a state of glorious uncertainty as to the magnitude of the fortune destined ultimately to emerge, the man who lives on a salary or wage is more likely to aim at a definite amount of saving (for instance a life insurance) and so to adjust his consumption as to maintain the prospect intact.

But heavier taxation of wages and small salaries is in contradiction with the policy of maintaining the standard of living of the mass of people. Will not taxation for debt redemption and the social services be at cross purposes?

35. *The Subsidies to the Cost of Living*

And what of the subsidies? They have recently been estimated at some £300 millions. Under peace conditions the cost of imported goods is reduced by the elimination of insurance against war risks, and freights may be less. But, if the quantities consumed are to be increased above the war-time level, that will call for a proportional increase in the cost of the subsidy. The mere existence of the subsidy necessitates the continuance of rationing. To offer cheap imported food without any restraint on consumption, at a time when national solvency demands a restriction of imports to the lowest possible total, would be ruinous. The country has, it is true, been spared the rationing of bread. But the demand for bread is regarded as inelastic, that is to say, it is not greatly stimulated by a low price.

It may be that, even without any subsidy, the restriction of imports would make rationing necessary. That is not certain. Rationing could be avoided if a sufficient

restriction of imports could be ensured by excluding or severely restricting those outside the list of staple requisites, but that cannot be counted on. The country may have to reconcile itself to the anomaly of rationing foodstuffs and materials of which the world supply is ample. A scarcity due to insufficiency of the country's command over imported supplies is just as real as a natural scarcity, and calls for the same palliatives to save the poorer people from having to bear the brunt of the privation. If the subsidies stop, what will be the consequences? Would the working people accept a rise of, say, 10 or 15 per cent in the cost of living without insisting on an increase of wages? An increase of wages would be no remedy. In determining the foreign exchange value of the pound the wage-level must be an essential consideration; rates of exchange must be such as to make the country's exports as productive as possible. A rise in the wage-level, if it is not to affect exports adversely, must be compensated by an equivalent reduction of the foreign exchange value of the pound. And that will raise the prices of imported supplies in the same proportion, while at the same time the wage-level itself would raise the cost of home-produced supplies. Nothing would be gained in real wages.

If the wage-earners are convinced by this argument, will they consent to the subsidies being teiminated? There is a direct conflict between fiscal policy and the policy of upholding the standard of living. An uncompromising adherence to the latter may cause a breakdown of the former; it may impose a fiscal burden which the administrative machine and the economic system cannot sustain.

That the conflict will ever reach this acute stage must

not be taken for granted. We are in the region of conjecture—not as to the principles but as to the facts.

The principles are clear and ineluctable. In a community where enterprise depends on profit-making, costs and therefore wages cannot be raised beyond their due proportion to prices without eating into profits and causing unemployment. Prices and costs at home are linked to prices and costs abroad through the value of the money unit in terms of foreign money units in the foreign exchange market. That value must be low enough to afford the required stimulus of profit to the export industries, and a sufficient deterrent on the purchase of imported goods.

A governmental policy of maintaining the standard of living has to intervene somewhere in this causal chain. Up to a point it can subsidize wage-incomes through the social services and the cost of living. But it should not be overlooked that the subsidies towards the cost of living are not unequivocally directed to maintaining the standard of living; if they are accompanied by rationing, the limitation of the amount consumed is a loss to be set against the advantage of cheapness.

Rationing is needed to keep down the volume of imports. If there is a restriction of imports other than staple requisites, to that extent the limitations on the staple requisites imported can be less severe. But this restriction is still to the detriment of the standard of living, less essential, no doubt, than a restriction of staple requisites, but it will not fall exclusively on the well-to-do. And, when the supplies of anything which cannot be rationed are restricted, the price rises, and it is the people of small means who have to do without it.

36. *What of Collectivism?*

Seemingly we have a hard path to travel, a treacherous path, from conflict of aims to cross-purposes, from cross-purposes to dilemma, from dilemma to morass. What emerges is the grave possibility that the nation cannot make ends meet. In order to maintain its standards, it has to encroach on the surplus which provides the means of discharging its liabilities. That surplus is composed in the main of the incomes derived from profit. Out of profits are paid rents and interest and the high salaries and fees enjoyed by professional men and experts. So long as the economic system is based on profit-making, enough of the surplus must be kept in being to provide the incentive of private enterprise. The upshot is (or at any rate there is grave fear that it may be) that there is not enough to go round.

And eager spirits will be found among us to say that the path is not closed, for there is a turn *to the left*. Let us dispense with profit-making, throw aside this division of the surplus between the leaders of enterprise and the mass of workers, and hand over the leadership and the profit to a single authority, the State.

The nation can be rallied in war to a single-minded effort by a democratically inspired discipline. Now that the effort has exhausted its accumulated wealth, the same devotion is needed to restore the nation's economic life.

Collectivism is repugnant to British traditions; it is hardly conceivable that so wide and deep a change could be made as an incident of party contests on the political plane. If it is to come, it must be not merely as the exploit of a Socialist movement or the trophy of a class war, but with the consent, even at the urgent demand, of all classes.

That British tradition which repels collectivism looks to the surplus as the source, alike of the public revenue which supplies the cost both of defence and of social services, and of the accumulation which supplies the essential equipment of industry. What remains to the profit-maker to spend on his own consumption may be quite a modest proportion, but the accumulation is his voluntary act and forms part of his private fortune. It is still at his command.

The profit-making traders, whether industrialists, merchants, financiers or others, are discharging a public function, estimating demand and taking measures to satisfy it; profit is the remuneration of selling power. The Communist Manifesto of 1848, in which Marx and Engels declared the Class War, compared the industrialists to feudal lords, exercising what is in essence delegated power, and receiving by way of remuneration not the feudal ownership of land, but the profits derived from ownership of the material means of production. The comparison was not without plausibility. What collectivism proposes is the surrender of this feudal independence and of the remuneration attaching to it, and the entry of those who have hitherto enjoyed it into the direct service of the State.

In current controversy collectivism is advocated mainly on three grounds: that the system of remunerating those in charge of enterprise by allowing them the whole residue of the earnings after meeting costs gives rise to a flagrant inequality of incomes; that the authority exercised by employers over workpeople is undesirably autocratic and irresponsible; and that reliance on profit as the single stimulus of enterprise is inconsistent with the planning of economic activity in the widest public interest. On the other side it is urged

that State-managed industry is bound to be less efficient than a system in which every industrialist's efficiency is directly reflected in his own income; that an independent industrialist is in a better position to exercise initiative than one responsible to an official superior; and that big incomes and fortunes in the control of successful industrialists and others are an indispensable condition of large-scale innovation and development. It is not very difficult to make a case on either side. To each of the main arguments there are answers, to the answers retorts. It would undoubtedly be hard to reach a decision by assessing the relative weight of the arguments.

But suppose the charges on the profit-makers' surplus become so great that there is no longer anything left for their personal remuneration consistently with the discharge of the country's liabilities and the support of its burdens, what then? Will the profit-makers offer a direct challenge to the wage-earners, and claim that their own margin must be maintained even at the expense of the wage-earners' standard of living? Even if they or some of them think that that would be the right solution, surely it is not practical politics. Against them would be rallied both the forces of democracy and those of organized labour. Even the unwilling would have to bow to the inevitable.

But all would not be unwilling. These people, the industrialists, merchants and financiers, are well accustomed to have regard to national interests. Not that they are more patriotic or public-spirited than their neighbours, but that the responsibilities of the power they exercise inevitably bring them into close contact with the Government and with considerations of public policy. It is under war conditions that this side of their vocation becomes most conspicuous, but it is always

present. As a body they would be willing to do much to preserve national solvency. After their experience of war-time taxation, the pecuniary loss would not look so very terrible. And they would be in a position to stipulate for terms and conditions of service which would give scope to their special skill and experience.

Whether heroic measures will really be necessary remains to be seen. The harassing and dangerous transition from war to peace conditions must be accomplished before it will be possible to take stock of the country's economic position. And even then it would be desirable to avoid being forced into a definitive decision whether to take the plunge or to re-establish a competitive system.

37. *A State Monopoly of Wholesale Dealing*

In my *Economic Destiny* (pp. 354–6) I ventured to suggest, as an interim measure after the war, a Government monopoly of wholesale dealing. This, if practicable, would not only keep open the question whether to advance into collectivism or to retreat upon competitivism, but would supersede a great part of the detailed controls by which trade and enterprise would otherwise be unavoidably trammelled.

Production (other than agricultural production) is in general undertaken in response to *orders* given to the producers; so far as the producer is concerned, sale is then already assured before he commits himself to any specific output. The function of the wholesale dealer is to procure supplies from the producers in response to the demands of the retailers. By giving orders to the producers he *starts* production; it is on his initiative that the mechanism is actuated.

If wholesale dealers fulfilling this function existed in every trade, a monopoly which at a stroke made them all agents of the State would confer on the State the power of regulating to a nicety the productive activity of every industry, and the prices to be paid to the producers (subject to the condition that the prices must be such as to afford sufficient inducement to accept the orders). The practical position is not so simple as that. It is possible for a retailer (at any rate one trading on a large scale) to get in direct touch with producers, and to give them orders without invoking any intermediary. And there are numerous and extensive sections of industry where this is a usual practice. There are both big retail businesses which give direct orders to producers, and there are big manufacturing businesses which supply numerous retailers (including many small ones) direct. In these cases a representative of the State would have to be accepted to take over the part of the business corresponding to that of a wholesale dealer.

Suppose, for example, that it is the practice of hosiers to be supplied with socks by wholesale traders, and of the wholesale traders to order the socks from the makers. The institution of the State monopoly would, in effect, prohibit direct sales from makers to retailers, and certain intermediaries would be specified to whom the makers would be required to sell their socks, and from whom the retailers of socks would be required to buy. The intermediaries would be the same wholesale traders who had actually been engaged in this branch of the wholesale trade, and would deal for the most part with the same makers and the same retailers as before, but they would be accountable to the State for both purchases and sales, and they would not retain the

resulting profit, but would receive remuneration on an agreed and limited scale.

There might be a big manufacturing concern accustomed to sell socks with its own known mark to a wide circle of retailers. It has been its own wholesaler. It will have a selling branch as an essential part of its own constitution, and the monopoly will require this branch to become accountable to the State on the same footing as a wholesale dealer. The prices received by the manufacturer will be fixed independently of the prices paid by the retailers, the difference being not unlike a purchase tax to be retained by the State.

Again there may be a big retailer of socks who buys direct from several makers. He must be subjected to the same treatment as the rest. He will have a buying department which must become an agency of the monopoly. The buying department may be manned by the same individuals as before, but with a change of status in that they become accountable to the State.

The traders thus taking service under the State would be called upon to exercise the same functions as in the ordinary course of their business, maintaining relations with the retailers and producers they know, supplying retailers from stocks of goods, and giving orders to the producers for the replenishment of their stocks. But in all their transactions they would be accountable to the State. They would be remunerated by commission or salary, and profits would go to the Government.

They would carry out a prescribed price policy. Their intervention would immensely facilitate the enforcement of a price control; for the prices paid to producers and the prices charged to retailers alike would be embodied in transactions with traders acting as agents of the Government itself.

Price control is endangered by the presence of redundant money, which creates a demand in excess of that arising from current incomes. The redundancy of money is not to be reckoned by simple arithmetic, allowing so many days' income for normal balances, and treating the excess as redundant. An essential item in the calculation is the consumers' needs. When consumers are suffering acutely from shortages of the things they are accustomed to have in hand or at their disposal, and from arrears of upkeep and renewals, almost *any* money they may hold is redundant, in the sense that it will be disbursed as soon as the opportunity of spending it to meet some pressing need offers. So long as these acute shortages are present, the most thorough excision of redundant money that can be contemplated will still leave a potential threat to price control, and it is important that the price control, if imposed at all, be so applied that its enforcement will be as complete and effective as possible.

The elimination of the unquestionably redundant excess of money, so far as practicable, is none the less important; for its continued existence would inevitably make the enforcement of price control, whatever the administrative machinery, incomparably more difficult.

The concentration of wholesale dealing in the hands of the State would have the further advantage that it would confer upon the State full control over the volume of supply of every sort of industrial product. Excluded from its purview would be the services rendered directly by producer to consumer, such as cleaning, repairing, the preparation of food, domestic service, and the making up of clothes. Services will be less affected by a general shortage than material products of which consumers and traders hold stocks, though they feel the

pressure of competition in the labour market. Repairing, however, in all its forms must be very directly affected, both because after the stress of war there are heavy arrears of upkeep to overtake, and because a shortage of new supply necessitates a postponement of renewals and continued use of things which would otherwise be discarded. Repairing of personal and household equipment is a very material part of the cost of living, and it has not been excluded from the scope of war-time price controls. It is not easily susceptible of a comprehensive control, but on the other hand there is much of it which people can do for themselves.

38. *Fixed Property and Plant*

Repairing of houses and other fixed property and of industrial plant is a much more serious matter. It is an integral part of the big problem of arrears of capital outlay on maintenance, renewals, improvements and extensions. A Government monopoly of wholesale dealing does not altogether cover the ground. It facilitates control wherever materials or industrial products have to be used. But in general the orders given to contractors for capital outlay of this kind are not given through wholesale dealers.

So far as the building trades are concerned, it is certain that a high degree of regulation by authority will in any case be unavoidable, in order to deal with the housing crisis, as well as the critical deficiencies of industry and business, for a considerable period of years. The activities of all available builders will have to conform to priorities instituted in the public interest. How this regulation will be administered it is not necessary to consider. It would evidently be something

quite distinct from a monopoly of wholesale dealing, but the underlying principle would not be very different; the orders given to the builders would be canalized through a Government agency, like the orders given by wholesale dealers to manufacturers.

In part, the same considerations apply to the supply of industrial plant. Much of the work to be done will be the making good of critical deficiencies, and will in its way be as urgent as the building of houses. But it is not likely that the Government will take command of the industries concerned in this work in so thorough a manner. The industries concerned cover a much wider range and are much more various than those composing the building industry. The products of a part of them are of the kind that can pass through the hands of wholesale dealers, and of these the output and prices can be regulated by means of the monopoly of wholesale dealing. But that does not apply to the constructional side of the industries, which is concerned with the installation of plant rather than with the manufacture of its component parts.

The controls applied to consumable products which are in short supply take the form partly of rationing the available supplies, partly of securing additional supplies by intervening in the business of production and importation. They do not involve discrimination among *users* (except in so far as the occupations or other circumstances of individuals justify special rations). Subject to the limitations of rationing, consumers are allowed to show their preferences through their purchases in the market. Demand can be modified by suitable adjustments of price or of indirect taxation, but that is not necessary to the working of the controls.

But in the repair, renewals and extensions of indus-

trial plant, rationing is not possible, and, if there is to be any allocation of resources according to needs, there must be a detailed scrutiny of the needs. Surely a formidable undertaking! Yet it is presupposed in any system of control of capital outlay.

The scrutiny is often represented as one discriminating in favour of the more essential needs and against the superfluities. If the entire productive power of the community were required for the former to the exclusion of the latter, that would be a solution. But as we saw above (pp. 18–19), there is a limit to the amount of resources that *can* be applied to essential needs. Even if essential needs are incompletely met, and people are under-housed and undernourished, and are compelled to make old things do, their desire for the superfluities they can get will not be any the less. Given that whatever can be done to direct productive resources to essentials, and to give them priority, is done, there still remains the problem of allocation among all the remaining requirements.

39. *Planning Supply and Demand*

The first requisite no doubt is to make good the critical deficiencies. But how are the critical deficiencies to be discovered and their relative urgency assessed? For this the State monopoly of wholesale dealing would give facilities not easily otherwise obtainable. The wholesale dealer offers orders to an industrial concern. If the concern is in a position to produce, the orders are accepted and executed. But the response to the offer may be that the goods cannot be produced or can only be produced under some serious disadvantage of delay, inferior quality or high cost. Is this remediable? Can

the remedy be promptly and easily applied? If so, facilities can be offered along with the order, and the appropriate priorities will smooth the way to productive activity. Thus the ordinary procedure of ordering goods from producers will of itself reveal the critical deficiencies, and, when the orders are given by wholesale dealers who are agents of the Government, the machinery of Government can be set in motion to remedy the deficiencies.

The Government through its agents will be responsible for the volume of orders given to each industry. How is that to be settled in each case? Under normal commercial practice the wholesale dealer is receiving orders from the retailers, and gives equivalent orders to the producers in order to keep up the amount he holds in stock. Supply, therefore, just keeps pace with demand. In the absence of any reason to the contrary a State monopoly of wholesale dealing would work in the same way; it would simply transmit to the producers the demand disclosed by the sales of the retailers.

Under conditions of post-war scarcity demand for nearly everything will be in excess, but the Government can use its monopoly to restrict the orders given to producers to what they have the capacity to produce.

For some products the excess demand will be eliminated by rationing. For some free play can be allowed to prices to rise high enough to check demand. For others again a prescribed retail price can be made a condition of supply to retailers, and the retailers themselves left to impose an informal rationing on their customers. The plans of the producers in regard to the capital outlay designed to refit or extend or adapt their equipment will be governed by the volume and character of the orders they receive, and for these orders

the responsibility will rest ultimately on the Government acting through its agents and with the help of their advice. The critical deficiencies of the various industries will be disclosed by the practical process of executing orders emanating from the Government itself.

The wholesale monopoly would confer on the Governmen a very far-reaching control over the economic life of the country, carrying with it the responsibility both for determining the degree of activity of each industry through the volume of orders given to it, and for regulating the supply of each product to consumers and the price charged for it through the sales made to retailers. A planner's Paradise!

But it is a mistake to claim too much for planning. Scarcity compels certain priorities. But staple requisites and critical deficiencies once having been provided for, it is dangerous to attempt any further discrimination in the character of the consumers' needs to be met. Demand, in the shape of money offered in the market for a product, affords *prima facie* evidence of the extent of need. In order to penetrate further, official scrutiny would have to be directed to the infinite multiplicity of individual circumstances and make comparison in a judicial spirit. It is the investigation of individual circumstances that causes the delays and expenses of legal proceedings. It has to be introduced (but only in very summary fashion) into some branches of administration. Surely, to base the whole business of distribution of goods upon it could only end in deadlock and breakdown.

The intervention of the Government between retailers and producers can be used to limit the orders to producers to something less than the retail demand would give rise to if uncontrolled. The pressure of excessive

orders, which would otherwise cause them to raise their prices, and from prices lead to a rise of wages, is moderated. Moreover the controls can be so exercised as to replenish the wholesalers' stocks of all kinds of commodities. Of any product of which there is an insufficient stock supplies to retailers can be kept down below the current output of the producers. The shortage is a hard fact, and the balancing of the inconvenience of insufficient stocks against a more prolonged curtailment of consumption is a choice of evils. Ultimately, the reconstitution of adequate stocks of all consumable commodities is almost a necessity, if a waste of time on endless fruitless quests is not to be the usual accompaniment of shopping. It is the wholesalers' stocks that provide the essential reserve, from which retailers' stocks are kept up to the necessary level.

Informal rationing of customers by retailers is apt to be vexatious and unfair, and cannot be relied on except for a limited period. For goods for which systematically enforced rationing is impracticable, high retail prices are eventually inevitable, if shortage persists. There may be a few staple requisites which are not rationed and of which the Government organizes supplies at low prices, but that draws on the productive resources of the country, and intensifies the scarcity of other things. In general, outside the limits of rationed goods and specially supplied staples, high prices must be the rule so long as scarcity prevails, prices, that is to say, high in relation to the prices received by producers. There is a disproportionate wholesale margin between the price paid by the retailer and that allowed to the producer. The margin accrues to the State (subject to the commission allowed to the trader who is acting as the State's agent) ; it is in the nature of a purchase tax.

though the administrative machinery of a tax is not sufficiently elastic to be suitable.

The monopoly of wholesale dealing would also solve some of the problems of international trade. The Government would rely on the single organization of wholesale dealers to give the appropriate orders for home trade and export trade to the producers who serve both. Through them it would be possible to make goods available for export by restricting the supplies made available for consumption at home. Theirs also would be the responsibility for quoting export prices. They would see to it that exports were sold at world prices, and that price concessions made to extend sales were not carried too far, particularly not so far that the total proceeds were not increased or were actually diminished.

The import trade could be similarly systematized. A severe restriction of imports at once raises problems of discrimination among sources of supply. The world has learnt to look with suspicion on bilateral bargains, and it is not easy to fix import quotas otherwise. But a body of merchants holding delegated authority from the Government would be in a position to act impartially in distributing orders up to an assigned limit of quantity among competing foreign producers on strictly competitive principles. The share of the trade assigned to any particular country would depend on the competitive efficiency of its producers, and not on any arbitrary quantitative allocation. The merchants could at the same time take long views and avoid inflicting any unnecessary discontinuities on their suppliers.

Section 9 of the Financial Agreement with the United States requires quantitative import restrictions by either country not to discriminate against the products of the other. There is no unequivocally right formula

for determining what non-discriminatory quotas should be. But an organization of importing merchants could be given instructions which, if followed, would clearly avoid discrimination.

40. *British Resources and Power*

In all these various functions the Government would have to ask the traders to place their skill and experience at its disposal. Unless they were prepared to serve the nation as loyally as in time of war, the whole plan would be liable to degenerate into abuses. It would not be only the welfare of the masses in the near future that would be at issue, but the future power of the nation and therefore of the Empire.

That power has been built up in the past by commercial and industrial enterprise. We, like any other country with a great history, are proud of our military virtues. But military virtues alone do not make a Great Power. Power has always depended also on resources, and far more so now than ever before. In the two great wars of this generation Great Britain has been using up her resources, and she is now face to face with exhaustion.

We all hope that the world has come within sight of a final renunciation of war. But a critical phase has been reached. If the basis of world politics is to be transformed, and war ultimately eliminated, the leadership must rest, for a lengthy period of transition, with the Great Powers.

Among them an essential part is reserved for Great Britain. For no country, great or small, is more wholeheartedly set on the new ideal of peace. The transition period is one of strange paradox. For the ideal of peace is to be enforced by power, in other words, by the

capacity to make war. Only when the rule of peace has been experienced long enough for people all over the world to appreciate it, and to regard any plan or aspiration for gaining political ends by force as a crime against humanity, can military power be left out of the reckoning.

Therefore, whatever the economic future of Great Britain may be, it will be vital to preserve those capacities upon which the past accumulation of her resources has depended. Production is the source of wealth. But as we saw (above, p. 23), the needs to be met are an essential condition of any activity being counted as production. The strength of a mercantile nation is founded in the merchants' skill in marrying production to needs.

I have described profit as the remuneration of selling power and selling power consists in discovering the needs to be met and providing the means of meeting them. That applies to the producer's profit as well as to the middleman's. Whoever installs and equips a productive enterprise is anticipating a demand for the product. If his expectations are realized, he makes a profit in proportion to the output he can sell. He has to take a long view, corresponding to the life of his plant, and probably extending beyond it to an indefinite future in which the plant is to be repeatedly renewed and improved. The merchant, on the other hand, can take a relatively short view. He locates and measures the actual or immediately pending demand, and obtains supplies from the producers already in a position to produce them. Every item sold yields a price, and the excess of the price over costs of production, transport and handling is the fund out of which the remuneration of the producers, merchants and retailers is found.

The cost of production is measured in hard work, and in the wages and salaries paid for the time of the workpeople engaged upon it. The profit-makers also contribute hard work, but their remuneration is not proportioned to the amount of work done. Success in the exercise of selling power is crowned with a handsome margin of price over cost, and the fund yielded thereby to the profit-makers is proportional to the amount sold. There is a vivid contrast between the easy gains of the profit-makers, once their business is in being, and the hard-earned recompense of the wage-earners and salary-earners. It is from the easy gains that the accumulations of wealthy nations have been made.

The easy gains are those derived from multiplying transactions once the opportunity has been seized or made. The seizing or making of the opportunity may be anything but easy. The great commercial nations, past and present, have been those that have excelled in this function. It is through such opportunities that production is married to need, and thereby is fruition generated. The more elaborate the division of labour, the more remote is the productive process from the need to be satisfied; the greater the scope therefore for a directing guidance. When the division of labour becomes international, and frontiers may separate production from need, the merchant who finds markets and reaps profits outside his own country comes on the scene. The pioneer merchant would be an adventurer facing hazards for the sake of high profits; in his footsteps would follow a mercantile community enjoying an established business, and deriving easy gains from multiple transactions. So in ancient times Babylon, Tyre and Carthage grew rich, in the Middle Ages

Venice, Florence and the Hansa Towns, and later Antwerp, Holland and London.

These commercial centres have usually been favoured by geographical position and political circumstances as well as by the aptitudes of their people, but the foundations of their power, once established, have been in the expert skill and experience of the merchants.

Highly specialized knowledge and judgment are needed in international trade. Most of the trade is in materials or intermediate products destined for some further process of manufacture before becoming ready for consumption. Even of an apparently simple staple material, such as cotton, wheat or coal, there are sure to be numerous grades, types and varieties, and it is for the merchant to supply just that quality which will best suit his customer's purpose. The knowledge on which a merchant's business depends is knowledge not only of the varied qualities of the commodities he deals in but of the varied needs of the people he sells them to.

Great Britain has long been pre-eminent for its commodity markets. These markets have rendered services to producers and consumers all over the world, and from all over the world have come the profits yielded. The financial business of which London has been so conspicuous a centre has grown out of the commercial business. The former, like the latter, demands special skill and knowledge, which have grown up with it. The country's shipping business has evidently also been closely associated with the mercantile business. Historians often describe the special business of a mercantile centre as the "carrying trade" and in the days of slow and precarious communication commerce and shipping were inseparable. Under modern conditions, they are not quite so closely linked.

But the shipowner serves the needs of the merchant, and his business depends on his understanding those needs and adapting his organization to satisfy them.

Along with the development of this commercial, financial and shipping business, Great Britain has also evolved a great exporting industry. But the exporting industry alone without the others would not have gone far to create the immense accumulation of wealth which we have seen used up in fighting two great wars. If the great position of the country is to be restored, the specialized skill and experience which have served it so well in the past must be given full scope in the future, whatever the economic system adopted.

The task confronting the country resembles the waging of war, in that its magnitude transcends the capacity of let-do to bring all the requisite economic forces into operation by the free play of prices in free markets. There must be a single leadership to direct them. Under let-do the leadership is delegated to the profit-making traders, whether producers or dealers; this delegation must for the time being be in part revoked. But so to revoke it as to discard the services of those who have learned to exercise it would be ruinous. Their continued co-operation is essential.

41. *Co-operation of Workpeople*

And, as in war, the co-operation of the mass of workpeople, the wage-earners and salary-earners, is likewise necessary. That does not mean that they should work excessive hours, or suspend all restrictive practices for an indefinite period. No doubt many restrictive practices could well be reconsidered on their merits; some may be found not to be in the interests even of those

who practise them, and some to conflict with the interests of labour in general. But that is a side issue. The co-operation that is needed is a co-operation of the workpeople in *policy*.

The great effort demanded of the nation is an effort to combine maintenance of the standard of living with national solvency. The purpose of organized labour is to maintain the standard of living of the workpeople. Why, it may be asked, should they yield a compromise to national solvency? The answer that common honesty requires it may be challenged or made subject to reservations, for national obligations cannot be isolated from the circumstances of their origin and discharge. Nevertheless the answer surely is clear. In the first place, national solvency is a condition of national power. The mass of people in Great Britain assume responsibility for the country's influence in the world. All are concerned, both in maintaining the power upon which its influence in this imperfect world still depends, and in using the influence to make the world less imperfect.

But the idea that, by throwing national solvency to the winds, a short cut can be opened to a high standard of living is dangerously fallacious. The country's high standard of living has been attained through the powerful position it has built up as a centre of international trade and finance. Its overseas investments and its capacity for earning profits on overseas business enable it to acquire a vast mass of imports in excess of its visible exports. An essential condition of the re-establishment of these activities is continued reliance on our national good faith.

The profits and dividends derived from all this business do of course pass into private ownership. But

their effect on the standard of living is not any the less. Their presence makes a given price-level consistent with a higher wage-level.

The wage-level, the price-level, and the flow of money are closely linked together. If, when all are in due correspondence, the wage-level is raised, the price-level and the flow of money must follow it, or the alternative is unemployment.

When prices rise, claims for still higher wages follow. A little boy who wanted to drink sea-water, and was warned that it would make him thirsty, protested, "Never mind, there is plenty more." The resources of inflation are as illimitable as the ocean, but they yield nothing to those who exploit them. That way lies madness, as Germany found.

The co-operation of the workpeople in the economic future of the country means above all sanity in wage demands. Organized labour is a power in the community, and wage policy is its responsibility. Trade Union leaders are quite alive to the difference between a gain in money wages and a gain in real wages. And they are not unaware that a general rise of money wages means no more than a proportional fall in the value of the money unit. A country may have recourse to a deliberate depreciation of its money unit in order to relieve the burden of debts, public or private. An unworthy policy, only to be defended as a last resort, when the credit mechanism is breaking down. In any case, a policy quite outside the province of organized labour. Organized labour is concerned with the interests of wage-earners, not with those of debtors.

There is a danger of the wage-level being pushed up, not as a deliberate act of policy, but through the blind action of the labour market. Industries coping with

post-war shortages may compete with one another for labour, and bid wages up. When some rates of wages are increased, others have to be levelled up, and a general rise is likely to set in.

Self-restraint in pressing for increases is needed. Once the futility of a rise in the general wage-level in terms of money is recognized, any particular wage increase ought to be judged by reference to its relative claims; relative, that is, to those of other groups of wage-earners.

Wage policy thus requires a wider outlook than that of a single industry. It concerns the labour movement as a whole. It ought to be viewed in a judicial spirit, not only in holding the balance between one industry and another and between one craft and another, but in aiming at a true economic wage-level, the highest level of real wages just consistent with full employment.

Wage policy also ought to be linked up with the conditions of labour, the hours of work and all that affects the well-being of the workpeople. Whatever may be stipulated for has to be measured by employers in terms of additional cost of labour. It may be that what is beneficial to the workpeople can be granted at slight cost. But the cost may be heavy, and then must be allowed for as the equivalent of an additional wage.

The labour movement in its specialized function of collective bargaining is concerned with wages and conditions of labour. But, in its aspect as a political movement embodied in a labour party, it is concerned with all the great questions of economic life. Monetary policy, the standard of living, the social services, national defence, national solvency all come within its purview. It is here that the co-operation of labour in the nation's task can be called into play to match the co-operation

of the traders. Policy can be so framed as to maintain the standard of living, to give the wage-earner the substance not the shadow of a real wage.

42. *Controls*

If the pressure for a delusive rise of money wages is to be averted, a State monopoly of wholesale dealing will supply an invaluable means of defence. For it can be used to limit the orders given to producers, and so to interpose a shield between the producers and the full force of the demand arising from post-war scarcities. If that demand were allowed to force up the producers' prices, the wage-earners' claims for a share of the resulting swollen profits might well become irresistible.

I have advocated co-operation of traders with the State through the instrumentality of a monopoly of wholesale dealing. And the case for it seems to me strong. But, whether it be adopted or not, there is independently an imperative need for co-operation in the great effort. Without the monopoly producers will be exposed to the unrelieved pressure of demand, and it will indeed be difficult to enforce price control, or to prevent wages rising beyond limit. If at the same time no effective measures are taken to deal with redundant money, price control is certain to break down. Price-level and wage-level alike will disappear into the stratosphere.

Is exchange control to be relied on to preserve the foreign exchange value of the pound? Experience has shown that exchange control cannot stand against panic. If sufficiently thorough, it can be made legally complete, in the sense that no loophole is left for evasion which does not involve an offence against the law. But when

the alternative is ruin, people will not hesitate to offend against the law. So long as all foreign exchange business is done through customary channels, a control exercised through the banks will be effective; they will have cognizance of all transactions, and evasion will only be possible by a carefully planned course of deception. But as soon as the fear of a monetary collapse comes within range, new channels will be rapidly improvised, and evasion will be made easy to anyone who is prepared to break the law. Little can be done to trace illicit transactions without a censorship of postal and telegraphic communications, which can hardly be tolerated in peace-time.

But even if exchange control acted perfectly, and purchases of foreign money, securities and property were effectively prevented, the panic-stricken flood of purchases would be concentrated with all the greater force on real values, commodities, property or shares, at home.

Whatever else is done, the redundant money must be eliminated. A forced loan, supported so far as necessary by dear money (as being the milder alternative to an absolute refusal of bank advances), seems to be the only effective means to that end. If it proves insufficient, it may have to be repeated.

Failing adequate measures for that purpose, the redundant money is certain to break loose. Given good luck, its course may be halted somewhere short of utter collapse; the price-level and wage-level may be held at, say, a fivefold or tenfold increase, and the supply of currency and bank credit, which was redundant in relation to a national income of £7,000 millions, will be no longer redundant in relation to one of £35,000 millions or £70,000 millions.

But, whatever happens to money, the problems of shortages, of arrears of capital outlay, of critical deficiencies, of the standard of living, will still have to be faced. The critical deficiencies cannot be allowed to continue; it may be assumed that, with or without Government interference they will be remedied, for the people directly concerned will be acutely aware of their urgency. But it may take a long time to make good the shortages, and still longer to overtake the arrears of capital outlay.

So long as there is a shortage of stocks in the hands of consumers and traders, there will be a danger of a further rise of prices. Price control promises no remedy; it merely *prevents* the operation of the natural corrective of let-do, the rise of retail prices above what would normally correspond to the producers' prices. The same widened margin which checks consumption, yields wholesalers and retailers the necessary resources to accumulate stocks. If prices are so restricted that there is no widened margin, the incomes generated by production will continue to be sufficient to buy up the entire output, and will leave no residue to be added to stocks.

May not people refrain from spending the whole of their incomes, so that against a residue of unspent money there will be a residue of unsold goods? Not so long as demand remains urgent. If prices are allowed to rise, and the flow of money expands, there will be some accumulation of money, because people will need bigger balances. But the accumulation is unlikely to exceed the additional money value of the stocks for which traders have to pay higher prices. The accumulation of idle money is usually not an accompaniment of monetary expansion but a symptom of depression,

occurring when stocks of goods are already becoming excessive (when, for instance, dear money makes traders less willing to hold stocks.)

And whenever capital outlay, under pressure of arrears, outstrips current savings out of income, it generates additional incomes the spending of which draws upon stocks of goods and intensifies the shortage. One of the greatest advantages of the State monopoly of wholesale dealing is that it opens a way to breaking this vicious circle, and reconstituting the depleted stocks of goods.

43. *Can these Dry Bones Live?*

The monopoly, as we saw, calls for the co-operation of the merchants, who alone have experience of the business. Co-operation is indeed the essential condition of any solution of the immense tasks confronting the country.

The evils the world is suffering from are the dire consequence of a failure to co-operate. Whenever a divergence of aim between individuals or between groups of people occurs, there are primitive promptings, deep-planted in human nature, to coercion. Coercion means the subjection of one will to another by the effective threat of some detriment, loss, pain, injury, in the last resort, death. Co-operation means the voluntary acceptance either of one of the two conflicting aims or of some middle course. A quarrel between individuals, a war between nations, or a civil war between factions is an attempt by each combatant to coerce the other.

It is easy to see that violence is the worst possible way of settling the difference. There is no assurance that the stronger party will be the wiser or the better, and,

whatever the purpose or the result, the process of coercion itself consists in doing harm, so that both parties are likely to suffer from it. And this principle extends beyond the case of actual violence. Democracy has come in for much severe criticism from the pessimists of the present century. But of all the weaknesses that discredit democracy surely the most serious is *intransigence*. An intransigent party is one which is so devoted to its chosen cause that it refuses to co-operate with others in the work of government, unless its own policy is given full effect. Its intrusion perverts the working of representative government, for the intransigent party, whenever it holds the balance between the supporters of contending policies, can obtain promises to promote the measures it desires from one side or the other as the price of its decisive votes. Thus the policy of a minority can prevail as the result of a bargain. So long as all parties are aiming at the public welfare, no great harm is done. Mistakes may be made, but on the other hand, a minority may turn out to be wiser than their fellows and, if they are not, and discontent results, the malcontents can make their votes felt later on.

But what if there is intransigence on both sides? Intransigent parties refuse concessions to one another. So long as there are only two parties in the State, that which has a majority can work its will, but, when there are several, it may be that the legislature can agree on nothing, and that each party will use its voting power to make government impossible.

The due functioning of government is itself a paramount social and national need. A century ago, when the principles of Cabinet government and the responsibility of the executive to Parliament were being evolved, the Duke of Wellington, who was no democrat, con-

tributed to the evolutionary process the pronouncement that "the King's Government must be carried on." The duty of a representative legislature is not only to enact changes in the law but to observe this great over-riding principle and to apply it from day to day.

Fascism originated in Italy because the parties which controlled the majority in the Italian Parliament, the Socialists and the Popular Party, could not be got to co-operate. Great Britain, enjoying the advantages of long parliamentary experience, has suffered less than other countries of Europe from this trouble (though she has been by no means exempt in the past).

But the dangers of intransigence are not confined to the arena of Parliament. Organized labour possesses a great power in the community. It has come into being as a counterpoise to the industrial feudalism which delegates autocratic authority to employers within the limits of their fiefs. It has successfully established a balance of power in industry; wages and conditions of labour are settled by collective bargaining, and a sanction is found in a concerted refusal to work.

The concerted refusal to work is the natural resort of workpeople against an employer who will not agree to demands; failure of the buyer and seller of labour to agree on terms results in no contract being made and no business done. The parties go apart, and it is then for time to show which can least afford to wait. Deplorable, like all quarrels! Each side is inflicting loss on the other, and the upshot is an agreement which would have been accepted by both at the outset if they had foreseen the event.

The loss is not only to the parties to the dispute; in greater or less degree the rest of the community will

suffer too. When a stoppage extends to an entire industry, the detriment to the community may become serious, especially if the industry is one on which many activities are dependent. Organized labour in certain industries of this type (especially coal-mining and various forms of transport) have too often succumbed to the temptation to show their power and to put pressure on the community to yield demands over the heads of the employers. That is an abuse for which there is no easy and certain remedy. The failure of the coal stoppage and general strike of 1926 did much to warn the workpeople and the country generally of the nature of such a stoppage.

Attempts, whether by organized labour or by any other group, to put pressure on the community by inflicting injury and distress upon it are an approximation to civil war. They are the very antithesis to the kind of co-operation that the present grave situation urgently needs. They are usually the result of exasperation, and exasperation does not occur without a cause, good or bad. There is usually unreason on both sides. One danger which is only too clearly to be foreseen is that of widespread demands for higher wages, each of which separately seems to the applicants reasonable, but which, taken in the aggregate, amount to nothing more than a degradation of the money unit. Organized labour has the power to press these demands. Its leaders, it may be said, know well that they lead nowhere. But can the followers be expected to be equally alive to the consequences? It is not the business of the ordinary wage-earning workman or woman to study the intricacies of economic science, and, if it were, facilities do not exist to teach them to more than a small fraction of the country's intellectually capable population.

Yet the essence of the matter is not difficult to understand. No one would expect to benefit people by giving them more clothing coupons if there were no increase in the supply of clothing; it would mean either that proportionally more coupons would be exacted for each garment or that stocks would be exhausted before the coupons had been all honoured. That money in the form of banknotes consists merely of coupons or tickets is easily understood.

But the removal of monetary fallacies will not of itself dispose of the cleavage of interests. For the cleavage is real. Private enterprise demands that what the State takes out of profits be limited. The residue left to the profit-makers must not only be sufficient to afford an adequate inducement to enterprise in the form of the standard of living customary in their class; it must provide the resources for investment, and for the improvement and extension of the equipment of industry. Private enterprise is threatened. The immediate approach is through the social services, and the stage has already been reached at which a tax system concentrated on the well-to-do cannot raise all the revenue required. It is hardly going too far to say that, whatever the burden of social services may be, the share of taxation imposed in future on the well-to-do will be not far short of the greatest practicable. If that is so, the *whole* burden of the additional cost of the social services will fall on the classes below the well-to-do; thereby there may be a distribution of residual incomes better adjusted to needs, but on balance the possibility of raising the standard of living any further at the expense of the well-to-do has come to an end.

If that further improvement is to be achieved, the profit-makers' residue must be appropriated. That

would be the end of private enterprise. As I have already suggested, hard facts may compel this tremendous change, but it is vital that the community should enter upon it, if at all, with their eyes open, and with a general desire to make it work.

INDEX